

# Strategic Delegation: A Review, Theoretical Integration, and Research Agenda

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*This article reviews the strategic delegation literature and provides a theoretical framework that integrates this perspective into management research. The strategic delegation literature is built on the observation that, under strategic interdependence, delegation of decision making and accompanying actions can serve as commitments that influence competitive interactions with rivals and lead to beneficial outcomes. In this article, the authors first integrate diverse models and streams of research on strategic delegation in an organizing framework and highlight points of agreement and departure. This is the first comprehensive review of formal game-theoretical research purporting to show the strategic effects of delegation. The authors then integrate strategic delegation into strategic management and organization theory research in three main ways: They propose a common set of assumptions that would attune the strategic delegation perspective with other views and make it more relevant for management research, they outline ways in which the strategic delegation perspective can be linked to a set of theories of management, and finally they point out additional empirical research avenues that can exploit interindustry heterogeneity, intraindustry heterogeneity, and international differences in delegation instruments.*

**Keywords:** *strategic delegation; organizational design; competitive interactions*

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Delegation, or empowering one to act on behalf of another, is a *sine qua non* of the modern firm. Even though the neoclassical economic model treats firms as unitary actors motivated by the maximization of their owners' benefits, in almost all but the smallest firms, strategic decisions and actions are delegated to nonowners. Shareholders delegate strategic decisions to professional managers, who further delegate decisions to functional or divisional managers (Bower, 1970; Hoskisson, Hill, & Kim, 1993). Delegation of decision making to managers is efficient when managers allocate resources, including their own efforts, in ways that do not divert from owners' objectives. However, that separation in decision making also gives rise to conflicts among the actors involved. Then, unless managerial behaviors can be sufficiently supervised, delegation is more efficient the more closely the incentives of managers are aligned with those of owners (Baker, 2002). Accordingly, a rather impressive body of work has developed on related topics, including agency theory (Dalton, Hitt, Certo, & Dalton, 2007; Gibbons, 2005; Prendergast, 1999), organizational controls systems (Goold & Quinn, 1990), organizational structure (Keats & O'Neill, 2001), and strategic leadership (Finkelstein, Hambrick, & Cannella, 2008), and has explored efficient forms of delegation as well as the link between internal organizational choices and firm behavior and performance.

Although this body of work approaches delegation as an antecedent of agency problems that need to be attenuated, a separate research stream views delegation as a strategic tool that enables external commitments that cannot be credibly made without delegation of decision making to another, typically subordinate decision maker. Based on the strategic commitment theory (Ghemawat, 1991; Schelling, 1960; see Besanko, Dranove, & Shanley, 2000: chap. 8, for an overview), and akin to the role of irreversibility in competitive interaction (Chen & MacMillan, 1992; Chen, Venkataraman, Black, & MacMillan, 2002), this stream of research sees the design of delegation instruments, including managerial incentives and governance systems, as a credible commitment that will shape the focal firm's competitive interactions with its rivals. For example, consider a profit-maximizing owner of a firm who wishes to discourage potential entrants from joining the industry or incumbents from expanding output (Vickers, 1985). His or her public statements threatening an aggressive response to rivals' expansion are unlikely to be effective in achieving this objective because, once rivals have already increased their capacity, his or her profit-maximizing response would be to accommodate (i.e., reduce sales and keep the market price unchanged). Consider now that the firm delegates competitive decisions to a manager whose reward system is linked to objectives such as sales or revenue growth, thus encouraging the manager to trade off margins for higher volumes. Although this may lead to resource allocations that are not directly aimed at profit maximization, it may also allow the firm to make an aggressive competitive commitment (in this example, to higher sales volume) in its interactions with rivals and customers. These commitments will influence rivals' competitive behavior (dissuading or reducing their expansion) in anticipation, and ultimately improve the focal firm's ability to achieve higher profits. As this example suggests, in oligopolistic contexts, firms may obtain higher profits by delegating strategic decisions to managers who do not behave as profit maximizers (Vickers, 1985). Delegation choices might affect firm performance by strategically influencing the behavior of actual and potential rivals, the intensity of rivalry in the market, and the firm's ability to capture value. This causal mechanism represents strategic delegation (Fershtman & Judd, 1987; Sklivas, 1987), or what Boyer and Jacquemin (1985) call "strategy in organization."

The strategic delegation perspective provides a fresh approach to competitive dynamics and to the question of designing effective managerial control systems. It is distinct from the traditional view in that it emphasizes how delegation instruments, more generally governance systems, induce or constrain externally oriented (i.e., competitive) actions whose impacts are contingent on the response of current or potential rivals. Traditionally, in organization theory and strategic management, the design of delegation instruments, including managerial incentives and governance systems, is mainly internal looking: They can influence strategy implementation (e.g., high-powered incentives can encourage managers to act in the best interests of shareholders) and/or strategy formulation (e.g., managers who are compensated on market share may craft strategies that promote growth), but, either way, the focus is on the focal firm. Delegation decisions can be driven, for example, by firm performance (Cannella & Lubatkin, 1993), strategic orientation (Boyd & Salamin, 2001), or organizational culture (Van den Steen, 2010). Even when the external industry characteristics are taken into account, it is a contingency and hence exogenous to the focal firm's governance choices (see, for example, Datta, Guthrie, & Rajagopalan, 2002). Strategic delegation theory complements this perspective by highlighting that, under strategic interdependence, delegation instruments may arise endogenously to influence the competitive behavior of rivals and, hence, eventually the focal firm's performance. Firms can strategically manipulate their managerial incentives and governance systems to influence their managers' competitive choices. That, in turn, can serve as a credible commitment to particular courses of competitive action and alter competitive interactions with market rivals or potential entrants, and can lead to improved competitive performance. Therefore, delegation decisions may be both externally oriented to shape competitive interactions as well as internally oriented to achieve efficient strategy formulation and implementation.

In this article, we aim to bring this promising perspective to the forefront of strategy and organization theory research by providing a theoretical framework that integrates strategic delegation into current models of organizational delegation and control. We first integrate diverse models and streams of research on strategic delegation in an organizing framework. Starting with seminal contributions of Vickers (1985), Fershtman and Judd (1987), and Sklivas (1987), a sizable literature has developed primarily in economics over the past 25 years, generating theoretical predictions about the effect of delegation decisions on competitive interactions and outcomes in oligopolistic settings. The literature has evolved in parallel streams, focusing on different dimensions of the delegation decision. Based on our review of the strategic delegation literature, we categorize existing research by the emphasis on different dimensions of the strategic delegation process: (a) the selection of managers or agents, (b) the allocation of decision rights and organizational design, and (c) the provision of incentives. To our knowledge, this is the first comprehensive review of formal game-theoretical research purporting to show the strategic effects of delegation.

The remainder of the article focuses on integrating strategic delegation into the management research. Three seminal articles mentioned above (Fershtman & Judd, 1987; Sklivas, 1987; Vickers, 1985) alone had received more than 2,000 citations while we were writing this article, reflecting the notable diffusion of strategic delegation models. Yet since this literature has been published predominantly in economics journals and has been based on formal game-theoretical models, many of its findings have not been recognized by

management scholars. Only recently has this literature transitioned to empirical research (e.g., Corts, 2001) and received attention in strategy and management journals (e.g., Vroom & Gimeno, 2007). That is unfortunate given the obvious interest of management scholars in the interaction between internal organization and competitive interactions. Strategic effects of delegation are important for strategic management theory and practice because so many competitive interactions take place among firms or business units that operate in oligopolistic settings and are run by managers rather than owners. Equally important, the design of delegation instruments, including managerial incentives and governance systems, is under the purview of owners and/or shareholders and hence is a choice variable in organizational design.

We integrate strategic delegation into strategic management and organization theory research in three ways. First, we theorize how the prescriptions of strategic delegation models may change when a broader and more realistic set of assumptions, which are rooted in management theory and practice, are used, and we propose a common set of assumptions that would attune the strategic delegation perspective with other views and make it more relevant for management research. Second, we outline ways in which the strategic delegation perspective can be linked to a set of theories of management that are particularly pertinent: organizational control systems and strategic control theory, organizational structure and multidivisional form, strategic leadership, competitive dynamics, and business model competition. Finally, we point out additional empirical research avenues that can exploit interindustry heterogeneity, intraindustry heterogeneity, and international differences in delegation instruments.

### **Strategic Delegation: What Is It?**

The intellectual roots of strategic delegation go back to Nobel Laureate Thomas Schelling's theory of strategic moves. In his seminal book *The Strategy of Conflict*, Schelling (1960) discussed the use of delegates as a way to credibly commit a negotiating party to a position in a bargaining situation. Later work on game theory has established that an ability to commit to a clear path of action can be valuable when bargaining among a small number of players in various instances, including vertical negotiation relations between buyers and sellers and horizontal (competitive) relations among rivals and/or potential entrants in oligopolistic contexts (d'Aspremont & Gerard-Varet, 1980; Fudenberg & Tirole, 1984).

The value of commitment arises in these situations because by "binding oneself" (Schelling, 1956) a party can credibly commit to a pattern of competitive actions or reactions, and therefore affect the expectations and actions of other parties and the resulting competitive dynamics. For example, a number of studies have explored ways in which firms can use irreversible deployment of assets as a way to signal commitment to a market in a way that deters other rivals and potential entrants (Dixit, 1980; Ghemawat, 1984; Sutton, 1991). The strategic commitment literature highlights that strategic commitments, once they are made, can affect the decisions of rivals. For this strategic effect to occur, commitment should be visible, understandable, and credible (Ghemawat, 1991; see Besanko et al., 2000: chap. 8 for an overview). In the U.S. airline industry, for example, commitments that are

perceived to be harder to reverse and more credible, such as mergers and acquisitions, investment in creation of hubs, and feeder alliances with commuter airlines, are less likely to be responded to by rivals (and, if responded to, with a longer delay) than commitments that are easier to reverse or appear to be “cheap talk,” such as public announcements (Chen et al., 2002; Chen & MacMillan, 1992).

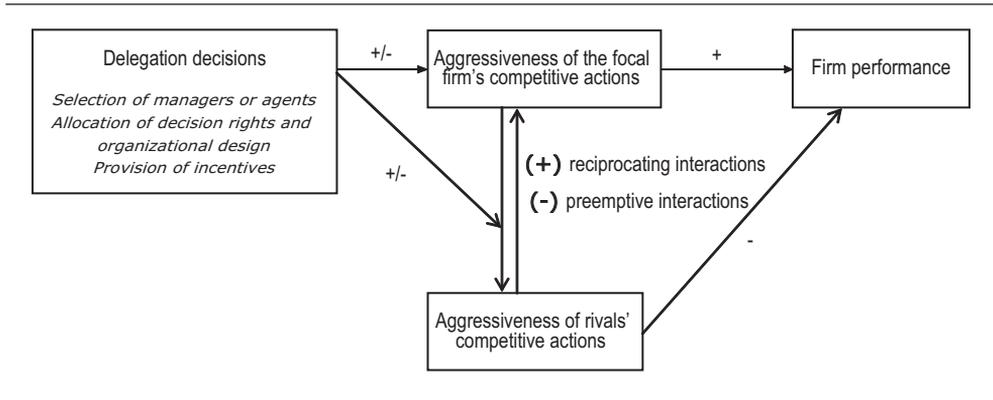
In a similar way, delegation of competitive decisions to agents with defined objectives allows firms to credibly commit to a course of action and thus influence the behavior of other parties (Gal-Or, 1997). This idea of commitment through delegation to agents was formalized by the game-theoretical industrial organization (IO) literature beginning with the work of Vickers (1985), Fershtman and Judd (1987), and Sklivas (1987), and a number of formal models have explored situations in which firms may benefit from such strategic delegation. This section reviews the major constructs in these theoretical models and illustrates several streams of strategic delegation research.

### **Strategic Delegation: The Basic Model**

The general theoretical model of strategic delegation suggests that a firm may gain from delegating decisions to managers whose motivations and incentives differ from those of their principals such as owners and shareholders. That is because delegation to such managers may constitute a commitment that influences competitive actions and competitive dynamics with actual and potential rivals. In terms of the causal mechanism linking delegation and performance, the strategic delegation perspective suggests that delegation to managers influences the focal firm’s performance through its effects on the aggressiveness of the focal firm’s actions and on its competitive interactions with rivals. How these competitive interactions unfold, however, depends on the competitive context. Thus, this perspective provides a theoretical link among four key constructs: a firm’s delegation decisions, its competitive behavior, its competitive interactions with rivals, and firm performance (see Figure 1). Although other streams of research in management have connected delegation dimensions such as organizational structure and incentives to firm behavior (see Keats & O’Neill, 2001, and Dalton et al., 2007, for relevant reviews), the unique contribution of the strategic delegation perspective is to examine the performance consequences of these decisions through their impact on competitive interactions. Therefore, the strategic delegation perspective demonstrates that organizational aspects within firms can shape competitive dynamics between firms.

*Delegation decisions.* In contrast to much of IO economics research and strategy research based on the IO paradigm, strategic delegation models do not treat firms as unitary actors. Using insights from principal–agent models, these models recognize that in a typical firm owners and shareholders delegate decisions to top managers who determine the strategic direction of the firm. Within the multidivisional firm, top managers might further delegate strategic decisions to divisional managers with responsibilities for products, markets, or functions. As a result, the incentives of managers who are taking competitive decisions are not necessarily automatically aligned with the long-term objectives of owners and

**Figure 1**  
**The General Theoretical Model of Strategic Delegation**



shareholders, and these managers respond to specific conditions of organizational delegation under which they operate.

In strategic delegation models, delegation itself is a two-step process (Basu, 1995). The principal (owners, shareholders) should first decide whether he or she will delegate the responsibility for some decisions to a subordinate or a hired agent. If he or she decides to delegate, then he or she should also decide how the delegation should take place. Typically, these two steps are highly interrelated. In settings where owner–managers are active players in the firms, the delegation decision itself may serve as a competitive signal (Fershtman, Judd, & Kalai, 1991; Kockesen & Ok, 2004). But in most settings, and in most firms, decisions are normally delegated from shareholders to professional managers and from top management to unit or division managers. Thus, the central aspect of the delegation decision is its design, in particular to whom the decisions will be delegated, under which organizational structure and with what extent of authority the delegate will operate, and how the delegate will be motivated and compensated. Models of strategic delegation, as we review in the next section, analyze different aspects of the design of delegation decisions and how they influence competitive interaction in oligopolistic settings.

*Aggressiveness of competitive actions.* Because of its roots in game-theoretical IO economics, strategic delegation models offer insights on the nature of competitive actions. Like strategy research in competitive dynamics (Chen, 1996; Smith, Grimm, & Gannon, 1992), these models recognize that companies can engage in multiple types of competitive actions, such as pricing, output and capacity decisions, advertising, and so on. Unlike competitive dynamics research in strategy, which has focused more on assessing the number and diversity of the portfolio of competitive actions (Ferrier, Smith, & Grimm, 1999), however, strategic delegation models use a formal game-theoretical approach to focus on competitive interactions in particular types of actions, especially their magnitude or intensity. In this perspective, competitive actions are considered to be aggressive when they offer more

value for money to a greater number of consumers (Sirmon, Hitt, & Ireland, 2007). Using the terminology of the value-based view (Brandenburger & Stuart, 1996), that implies that an aggressive action increases the potential customer surplus for more customers, by increasing willingness to pay, reducing price, or increasing capacity or availability, relative to rival offerings. Thus, everything else being constant, aggressive actions such as a price reduction, capacity increase, or a comparative advertising campaign would increase a firm's volume and market share since (a) price-sensitive consumers may now be enticed to buy (or buy more) from the focal firm and (b) rivals' customers may now switch to the focal firm's offerings. In contrast, nonaggressive actions tend to focus on increasing margins from existing customers rather than increasing volumes. By this definition, a more aggressive competitive action by a firm systematically hurts competitors since they would suffer a loss in revenues if they do not respond to the move.

The link between a firm's delegation decisions and the aggressiveness of its competitive actions lies at the core of strategic delegation. The specific causal mechanisms of this shift in firm aggressiveness may differ depending on the specific type of delegation dimension involved. Selecting managers, for example, who uphold a vision of being dominant in a market segment would bias the firms that they manage toward volume expansions relative to margins. Similarly, incentives based on market share, sales volume, or revenue growth may also favor volumes over margins. Task design, too, affects this trade-off. For example, managers with divisional responsibilities could undertake more aggressive actions if their task-related incentives do not include the performance of other divisions that provide substitute products. Regardless of the specific causal mechanism, delegation decisions influence the pattern of competitive interaction since they affect both the aggressiveness of the focal firm's competitive actions as well as the expectations of competitive response. For example, firms that delegate competitive decisions to managers with a more aggressive disposition would be (a) more likely to engage in aggressive unilateral competitive actions, (b) more likely to be credible in their aggressive moves, affecting the response of competitors, and (c) more likely to respond aggressively to competitor actions.

*Context of competitive interaction.* The principal contribution of strategic delegation research is that it provides theoretical predictions about how delegation decisions affect performance by affecting competitive interactions. It is this link to competitive interaction that has been missing from most prior research on organizations in strategy and management. Research on competitive dynamics and game theory argues that whether and how a firm's competitive behavior affects its performance depends on the likelihood, direction, and intensity of the responses that it generates (Fudenberg & Tirole, 1984; D. Miller & Chen, 1994). Understanding competitive response is particularly important in oligopolistic contexts, since, in contrast to monopoly or perfect competition contexts, in oligopolistic contexts firms are strategically interdependent.<sup>1</sup> Strategic interdependence refers to situations in which one party's outcomes (profits, rewards, benefits, etc.) depend crucially on the decisions of other parties and vice versa. Moreover, the context of strategic interdependence raises the importance of commitment to competitive actions (Ghemawat, 1991). Since firms may benefit from shaping their rivals' competitive responses, credible commitments to particular actions provide the basis for shaping competitive interactions.

In strategic delegation models, and in general in game-theoretical IO economics (Bulow, Geanakoplos, & Klemperer, 1985; Fudenberg & Tirole, 1984), the competitive context is conceptualized in terms of the direction and intensity of competitive interactions—whether the direction of the response will be in the same direction as the rival's competitive action (reciprocating interactions) or in the opposite direction (preemptive interactions).<sup>2</sup> In competitive contexts where firms focus on capturing limited market opportunities (such as new niches, market segments, or new geographies), a committed aggressive action by a firm tends to reduce the size and attractiveness of the opportunity for other firms, particularly when action requires investment. Thus, an aggressive competitive action by a firm tends to preempt actions by rivals or potential entrants. We refer to these situations as *preemptive interactions*. As a broad generalization, preemptive interactions might occur in growth stages of markets, when market opportunities exceed supply and where multiple incumbents and potential entrants exist, or in fragmented markets, with low barriers to entry and low barriers to exit. In these contexts, aggressive commitments by firms can discourage entry and expansion by other competitors, and may even incite exit and consolidation.

In contrast, in competitive contexts where incumbents focus on dividing existing market opportunities, a committed aggressive action by a firm erodes the market position of its competitors and increases the incentive for those rivals to undertake aggressive responses of their own. Alternatively, when a firm commits to reducing its competitive aggressiveness, providing competitors with a more attractive market position, competitors naturally respond by reducing their own aggressiveness to achieve higher profits. We refer to those “tit-for-tat” contexts where rivals reciprocate each other's competitive actions as *reciprocating interactions*.<sup>3</sup> Broadly generalizing again, reciprocating interactions are more likely to be observed in mature or declining markets, in consolidated markets with high barriers to entry and/or exit, and where firms engage in oligopolistic competition among a relatively stable set of incumbent players. Whether the competitive action is based on price, comparison advertising, or coupons, a more aggressive competitive action or commitment will likely lead to a more aggressive response, and vice versa.

The typology presented here of preemptive versus reciprocating interactions maps onto other important previous categories. Smith and his colleagues (1992) distinguish between strategic (e.g., capacity decisions) and tactical (e.g., pricing decisions) competitive actions. Strategic actions tend to lead to preemptive interactions, whereas tactical actions tend to lead to reciprocating interactions. Although related to it, this typology is not the same as the one adopted by strategic delegation models, which are principally concerned about the direction of response (in game-theoretical parlance, the slope of the best response function) and can lead to different predictions in different contexts. For example, capacity expansion, a strategic decision (Chen, 1996), can be both preemptive (e.g., in a capacity-based industry with changing demand patterns, like the Japanese beer industry; Kokuryo, Asaba, & Salter, 1994) or reciprocating (e.g., in an industry driven by installed base and competitive parity, like express mail industry; Rivkin, 2007).

*Performance implications.* In summary, strategic delegation moves can be seen as precommitments to act in ways that affect the competitive position of the firm in oligopolistic contexts. The outcome of strategic delegation depends on the combination of the causal

**Figure 2**  
**Market Performance Outcomes of Strategic Delegation**

		Nature of competitive interaction	
		<i>Preemptive interactions</i>	<i>Reciprocating interactions</i>
Effect of the delegation instrument on focal firm's aggressiveness	<i>Increase aggressiveness</i>	↑ Focal firm performance ↓ Rival performance	↓ Focal firm performance ↓ Rival performance
	<i>Decrease aggressiveness</i>	↓ Focal firm performance ↑ Rival performance	↑ Focal firm performance ↑ Rival performance

effects of delegation on aggressive competitive behavior and the nature of competitive interaction in the market (see Figure 2). By definition, a firm's performance is hampered by aggressive competitive behavior by actual and potential rivals. Strategic choices by a firm that reduce the aggressiveness of rivals should, therefore, have a positive effect on its own performance. Hence, delegations that make the firm more aggressive are beneficial when competitive interactions are preemptive in nature (since an aggressive action by a firm induces less aggressive action by rivals) because the firm's aggressiveness prevents aggressive actions by its rivals. In contrast, delegations that make the firm less aggressive are beneficial when competitive interaction are reciprocating in nature (where an aggressive action by a firm induces more aggressive action by rivals) because the firm's lack of aggressiveness would benefit rivals and deescalate product-market competition.

In addition to the strategic effect, delegation decisions can (and do) influence firm performance directly by influencing the efficiency of effort and resource allocation. This direct effect has already been explored in prior research in agency theory. For example, delegation may influence the amount of effort and consideration put in managerial decisions (Jensen & Meckling, 1976) and may divert efforts from one activity to another (Holmstrom & Milgrom, 1991; Kerr, 1975). Thus, the total effect of delegation on performance is determined by both the strategic and efficiency effects.

### Models of Strategic Delegation: A Review

This section reviews different research streams on strategic delegation that evolved in parallel streams under a novel organizing framework. In the following pages, we categorize existing research by the emphasis on different dimensions of the strategic delegation process: (a) the selection of managers or agents, (b) the allocation of decision rights and organizational design, and (c) the provision of incentives (see Table 1).<sup>4</sup> Clearly, all three dimensions are relevant in management theory and practice.

### *Selection of Managers or Agents*

The first important dimension of delegation involves the selection of managers or agents and the specific criteria for selection. Selection of managers is important because firm behavior at all levels of the hierarchy is to a large extent driven by overall strategic direction of the firm, which reflects top managers' broad strategic intentions (Noda & Bower, 1996). This follows the fact that managers have considerable discretion over firm behavior (Child, 1973), having managerial control systems at their disposal (Simons, 1994), and that they limit firm behavior because of their own ability and appropriateness to execute a strategy (Hambrick & Mason, 1984; Stafsudd, 2003). Because incentive and control systems are not perfect, managers' underlying preferences are likely to influence their behavior (Hambrick & Mason, 1984), even when principals are trying to impose other extrinsic incentives. As a result, top managers' personal characteristics affect not only which strategies will be chosen but also how these intended strategies will be realized (Battilana, Gilmartin, Sengul, Pache, & Alexander, 2010; Gunz & Jalland, 1996). Empirical work in management supported the importance of the selection of the delegate by showing that managerial behavioral patterns such as willingness to take risks and tolerance for ambiguity are affected by their background characteristics such as functional experience and age, and the match between managerial behavior and the "strategic mission" of the firm (i.e., the trade-off between market share growth and short-run profits) is important for firm performance (Gupta & Govindarajan, 1984a, 1985; Thomas, Litschert, & Ramaswamy, 1991).

The contribution of the strategic delegation literature has been to focus on the strategic dimension of manager selection, when principals choose their managers in anticipation of the behavioral shift in rivals' response. Given strategic considerations, managers are likely to be chosen according to some particular characteristics that are known to other principals and managers in the market—that is, managers have personal reputations, both internally within the firm (Rotemberg & Saloner, 2000) and externally *vis-à-vis* competitors and other stakeholders (Milgrom & Roberts, 1992). Yet reputation is never self-proclaimed (Clark & Montgomery, 1998): Top managers' personal reputations such as being sensitive in cost cutting or keen on acquisitions and their corporations' reputations are tightly intertwined (Gaines-Ross, 2003).

The strategic delegation perspective has long acknowledged the importance of the agent's characteristics. Schelling (1960: 142-143) famously noted,

The use of thugs and sadists for the collection of extortion or the guarding of prisoners, or the conspicuous delegation of authority to a military commander of known motivation, exemplifies a common means of making credible a response pattern that the original source of decision might have been thought to shrink from or to find profitless, once the threat had failed. (Just as it would be rational for a rational player to destroy his own rationality in certain game situations, either to deter a threat that might be made against him and that would be premised on his rationality or to make credible a threat that he could not otherwise commit himself to, it may also be rational for a player to select irrational partners or agents.)

This emphasis is reflected by early research on strategic delegation. For example, Fershtman and Judd (1987) speculated that a firm can commit to aggressive advertising by hiring a

manager who is known to be inclined to advertise aggressively. Later studies showed that the manager's type (performance preferences, patience, and resource commitment preferences) can indeed affect competitive outcomes and that selection of managers can be used as a commitment instrument (Englmaier, 2010; Goering, 1996; Lambertini & Trombetta, 2002; N. Miller & Pazgal, 2002). Hiring an empire-building manager, for example, is likely to increase the competitive advantages from strategic delegation when the firm is willing to dissuade capacity expansion by rivals (Krakel, 2004). Taken together, this research stream thus highlights that delegation of decision making to managers with known predispositions can be used as a commitment device that can strategically alter the competitive interaction among competing firms.

### *Allocation of Decision Rights and Organizational Design*

A second dimension of delegation involves the allocation of decision rights and organizational design, especially in multiunit firms. From the perspective of strategic delegation, these aspects take on greater importance when many competitive decisions are, of necessity, pushed down in the organization rather than retained by top managers. Most firms are active in multiple related value chain activities, such as research, development, manufacturing, marketing, sales, or service. Also, they often are in multiple markets, such as multiple regions, products, or segments. In such firms, competitive decisions are typically delegated to managers running each unit, especially when market-specific information is needed and it is difficult to transfer the requisite knowledge efficiently (Collis & Montgomery, 2005). The extent of managerial discretion over competitive decisions can be driven by the task environment, internal organization, and/or managerial characteristics (Hambrick & Finkelstein, 1987). It is particularly pronounced in multimarket, multiunit organizations because in these organizations managerial discretion is accompanied by organizational separation, that is, business unit managers run physically and organizationally distinct units (see Baum & Greve, 2001). The contribution of the strategic delegation literature to the vast literature in organization theory and management is to emphasize how the organizational constraints under which these managers operate can precommit managers to certain courses of action, which may affect competitive interactions and performance in oligopolistic markets.

*Allocation of decision rights.* A fundamental characteristic of the modern corporation is managerial specialization. Yet how much autonomy a manager will actually have depends on a multitude of factors, such as the size of the division, interdivisional spillovers, and diversity of a firm's businesses. In large corporations, particularly those that are publicly traded and with diffuse ownership, owners and directors observe performance outcomes, select managers, set incentive mechanisms, and may be involved in major decisions with a long-run impact on the firm, but they tend not to get involved in the day-to-day details of the firm's operations (Collis & Montgomery, 2005). Similarly, corporate headquarters of multiunit firms evaluate the performance and observe major decisions of their business units but do not get involved in these units' day-to-day operations (Holmstrom & Costa, 1986).

**Table 1**  
**Models of Strategic Delegation**

	Representative Publications	Main Propositions
<i>Selection of managers or agents</i>		
Selection of managers and agents	Goering, 1996; Lambertini & Trombetta, 2002; Englmaier, 2010	Delegation of decision making to managers with known predispositions can be used as a commitment device that can strategically alter the competitive interaction among competing firms.
<i>Allocation of decision rights and organizational design</i>		
Allocation of decision rights	Segendorff, 1998; Sengul & Gimeno, 2011	In contexts of reciprocating interactions, it is strategically more beneficial to limit the autonomy of managers in order to reduce the competitive intensity in the market. In contexts of preemptive interactions, on the other hand, it is more beneficial to give greater autonomy to managers because it provides a means to commit to competitively aggressive actions credibly.
Divisionalization	Schwartz & Thompson, 1986; Polasky, 1992; Baye et al., 1996	Presence or creation of multiple competing units in a given industry increase competition and reduce profits. But in contexts of preemptive interactions total gains from divisionalization can exceed individual losses of each division.
Vertical separation and transfer pricing	Bonanno & Vickers, 1988; Caillaud et al., 1995; Alles & Datar, 1998	Firms can benefit from competitive commitments in the upstream market by integrating vertical decisions or transferring resources in marginal costs in contexts of preemptive interactions. In contexts of reciprocating interactions, on the other hand, vertical separation can be more beneficial as it represents a credible commitment to limit competition in the downstream market.
<i>Provision of incentives</i>		
Profit-only versus mixed incentives	Vickers, 1985; Fershtman & Judd, 1987; Sklivas, 1987	In contexts of preemptive interactions, mixed incentives (that put some weight on sales or revenues in addition to firm profitability) are more effective. In contexts of reciprocating interactions, on the other hand, (over) compensation for profits softens competition and increases profits.
Absolute versus relative evaluation of performance	Salas-Fumas, 1992; Aggarwal & Samwick, 1999; Joh, 1999	Incentives that put a negative weight on rivals' performance result in higher performance for the focal firm in contexts of preemptive interactions. In contexts of reciprocating interactions, on the other hand, incentives based on absolute performance or incentives that put a positive weight on rivals' performance soften competition and increase profits.

(continued)

**Table 1 (Continued)**

	Representative Publications	Main Propositions
Market-share-based incentives	T. Jansen et al., 2007; Ritz, 2008	The effect is similar to incentives that put negative weight in rivals' performance. Furthermore, the tit-for-tat nature of market share incentives typically results in softer competition and higher performance, relative to mixed incentives, in contexts of preemptive interactions.
Incentives based on corporate versus divisional performance	Fauli-Oller & Giralt, 1995; Barcena-Ruiz & Espinosa, 1999	Under positive interdivisional spillovers, corporate-wide incentives are beneficial in contexts of preemptive interactions, but divisional incentives are beneficial in contexts of reciprocating interactions (and vice versa for negative interdivisional spillovers).

For example, business-unit managers may be given decision rights for tactical competitive decisions (pricing, allocation of sales resources and advertising, inventory management, investment in plant improvements) but may well be constrained within preestablished limits in regard to major decisions such as capacity increases, major capital investments, and budgets.

The strategic delegation perspective argues that it is through this separation that strategic advantages of delegation may emerge (Fershtman & Judd, 1987; T. Ross, 1987). After all, if hired managers have no discretion over firm behavior, net of potential agency costs, the firm will act as if it is run by the owners (as it is in the case without delegation) and delegation will not have a strategic effect. Therefore, the level of managerial authority or autonomy can be an important decision variable, which might be very limited ("weak delegation") or near absolute ("strong delegation") in practice (Segendorff, 1998). When a firm wants to commit its business unit to a softer competitive posture as in contexts of reciprocating interactions, it might be strategically more beneficial to limit the autonomy of the business unit (Vroom & Gimeno, 2007). That is because in an integrated (i.e., centralized) structure the investment hurdle rate in the internal capital market will limit resource allocation to the unit, reducing its ability to take a competitively aggressive posture. As a result, constrained reinvestment will turn the business unit into a "harvest" unit, likely reducing the competitive intensity in the market (Sengul & Gimeno, 2011). However, when a firm wants to commit to an aggressive competitive posture (e.g., in contexts of preemptive interactions), it might be more beneficial to give greater autonomy to the delegate for decisions pertaining to reinvestment because it provides a means to pursue growth credibly.

*Divisionalization.* Another dimension of delegation that influences competitive behavior is horizontal divisionalization, or the existence of multiple divisions by the same firm in a given industry (Bower & Christensen, 1996; Galunic & Eisenhardt, 1996). Consider, for example, General Motors's units with overlapping car segments, multiple branches of hotels

or banks in the same area, flagship airlines and their low-cost units, separate units for producing with old (existing) and new (emerging) technologies such as in hard-disk drives, brick-and-mortar and online units of banks or booksellers, or Procter & Gamble's system of brand versus brand rivalry. Even though the presence or creation of multiple units in a given industry can be inefficient and wasteful in terms of fixed costs of operation and/or lead to cannibalization, it might also have beneficial strategic effects. If, and when, divisions operate independently, creation of new divisions will increase intrafirm competition compared to the preentry situation (Polasky, 1992). Although increased competition will likely reduce unit sales and profits, the sales of the new division come both from sister units (cannibalization) and also from other firms operating in the market (Corchon, 1991; Yuan, 1999). Thus, in some situations where competitive interactions are of a preemptive nature, and with centralization of capacity decisions (Veendorp, 1991), total gains from divisionalization for the parent firm can exceed individual losses of each division (Baye, Crocker, & Ju, 1996; Creane & Davidson, 2004; Schwartz & Thompson, 1986). Furthermore, such controlled or intentional escalation of competition may also be effective in preempting rivals' expansion or deterring entry into the market (Gonzalez-Maestre, 2000; Schwartz & Thompson, 1986; Ziss, 1999). For example, when Australian flag-carrier Qantas created a domestic low-cost airline, Jetstar, in 2004, the presence of these units slowed the expansion of domestic rival Virgin Blue and blocked or delayed entry by other regional low-cost airlines such as Freedom Air, AirAsia, and Tiger Airways (Gimeno, 2010).

*Vertical separation and transfer pricing.* Allocation of tasks and decision rights within vertically linked activities in the value chain can also influence competitive commitments. There may be clear benefits within the firm for vertical integration when cospecialization among divisions creates value for the firm through differentiation or cost reduction. However, decisions that increase costs but also increase customer value (product variety, product quality, etc.) are likely to lead to interdepartmental negotiations and conflicts about recognition of the contribution of each department and value capture through internal transfer prices. Furthermore, when the downstream division is constrained from turning to the external markets to purchase inputs, this constraint creates a monopoly for the upstream division. When the upstream division is created as a profit center with managerial incentives to maximize divisional profits even at the expense of a downstream division, it can lead to distortions in decision making by the downstream division that are suboptimal for the firm overall. When both upstream and downstream divisions are created as profit centers, independent pricing decisions by the divisions can lead to price decisions that are too high with corresponding volumes that are too low. That is the well-known "double-marginalization" problem in economics (Lafontaine & Slade, 1997).

The contribution of the strategic delegation perspective is to recognize that vertical delegation schemes would have positive or negative competitive consequences in different competitive contexts (Caillaud, Jullien, & Picard, 1995; J. Jansen, 2003; Lin, 1988; Rey & Stiglitz, 1995; Ziss, 1995). Vertical divisionalization and the associated risk of double marginalization may be ineffective when the downstream competition involves preemptive competitive interactions, where the firm's constraints encourage aggressive behavior by rivals and potential entrants. When upstream units or corporate headquarters provide inputs

such as capital, R&D, and knowledge to downstream divisions at zero or subsidized rates or at marginal costs rather than average total cost, those provisions make the downstream units more competitively aggressive (Alles & Datar, 1998; Goex & Schiller, 2007). An extreme case is the “margin squeeze” strategy in telecommunications, where an integrated operator supplies network access to third-party service providers as well as its own internal downstream unit. Here, an integrated unit benefits from a lower transfer price that allows it to outcompete the independent downstream competitors (see, e.g., Geradin & O’Donoghue, 2005). Thus, in contexts of preemptive competitive interactions, firms can benefit from aggressive competitive commitments in the downstream market by integrating vertical decisions or transferring resources at a lower transfer price (Salas-Fumas & Ruiz-Aliseda, 2002). Such aggressive competitive commitments can be counterproductive, however, in the context of reciprocating competitive interactions because aggressive actions could escalate competition downstream (Lafontaine & Slade, 1997). In this instance, firms may benefit from making less aggressive commitments in the downstream market by creating separate (i.e., not integrated) vertical divisions and encouraging the upstream divisions to run as profit centers. In the extreme, they may commit to delegation of competitive and pricing decisions to independent “marketing” units that receive their inputs at unit prices that allow the capture of the value upstream (Bhardwaj, 2001; Bonanno & Vickers, 1988). This “vertical separation” represents a credible commitment to limit competition in the downstream market, particularly where divisional assets and/or activities are cospecialized and therefore less susceptible to being procured in an external market. Existing empirical work typically compares the competitive behavior and performance of independent owner-managed firms or franchises and those of company-owned units in a number of industries, including retail gasoline (Slade, 1998), motion pictures (Corts, 2001), and hotels (Vroom & Gimeno, 2007), with results largely in line with the strategic effect of vertical separation.

### *Provision of Incentives*

Providing managerial incentives is critical for aligning the actions of managers with desired firm objectives. This has been examined intensely by the literature on agency theory (Jensen & Meckling, 1976; Jensen & Murphy, 1990a; S. Ross, 1973), where the ubiquitous use of managerial incentive systems is driven by the desire of principals (owners) to align the interest of agents (managers) with their own. Incentive alignment induces efficient allocation of resources, including the efforts of the manager (Jensen & Murphy, 1990a, 1990b). To promote incentive alignment, incentive systems generally involve increasing the sensitivity of the agent’s reward to the economic performance of the firm (Eisenhardt, 1989). A fundamental role of incentive and control systems is therefore to provide ex ante evaluation criteria for managers to decide among alternative paths of action. Yet implementation of incentive systems requires appropriate managerial capabilities, and the systems may produce mixed results (Kerr, 1975; see Dalton et al., 2007, for a review).

Agency models have tended to assume a mechanistic link between management decisions and performance, ignoring the specific complexities of strategic interdependence in oligopolistic environments. Yet the effectiveness of incentives depends significantly on the

existence of a match among compensation strategies, organization, and environment (Balkin & Gomez-Mejia, 1987, 1990). Under strategic interdependence, competitors' actions can have both a direct effect on performance as well as an indirect effect through competitive interactions. This indirect effect is important because, in contexts of oligopolistic interaction, decisions that are optimal ex ante may not be optimal after the response of competitors has taken place, and providing incentives to managers to optimize certain performance dimensions does not guarantee that such performance dimensions will be optimal after the response has taken place (Vickers, 1985). Thus, to understand whether decisions that are optimal ex ante are also optimal ex post (after the response of competitors has taken place), it is important to consider what actions will be selected by managers given their incentive scheme and how competitors may respond to such actions.

*Profit-only versus mixed incentives.* In their seminal work on strategic use of incentives, Vickers (1985), Fershtman (1985), Fershtman and Judd (1987), and Sklivas (1987) explored the strategic implication of using "mixed" incentives that put some weight on sales or revenues in addition to firm profitability, which are commonplace in practice. Emphasizing sales or revenues influences managers' behavior because such an emphasis reduces their sensitivity to the cost and increases their sensitivity to volume. In general, most firms face decreasing marginal revenues and constant or positive marginal costs. Thus, incentives that provide a positive weight on sales or revenues encourage more aggressive competitive behavior such as greater output and lower prices than those that consider only profit. Accordingly, in reciprocating competitive interactions, volume-based incentives can be counterproductive since those incentives can lead to competitive escalation by all firms, resulting in collective losses. In this setting, then, each owner will want his or her manager to set a high price, keeping sales low, thereby encouraging competing managers to also raise prices.<sup>5</sup> Yet in preemptive competitive interactions, incentives that provide a positive weight on sales or revenues can be beneficial, since they increase the competitive aggressiveness of the focal firm, reducing existing rivals' incentives to expand and potential entrants' incentive to enter the industry.<sup>6</sup>

*Absolute versus relative evaluation of performance.* Although firm financial performance is generally measured in absolute terms, it is also common for boards and investors to evaluate firm performance relative to industry peers and rivals, particularly where compensation committees must evaluate CEO performance to determine compensation. The benefit of relative performance evaluation is that it provides a more reliable proxy for managerial behavior by extricating uncontrollable industry effects such as exogenous industry shocks (Gibbons & Murphy, 1990; Holmstrom, 1982; Jensen & Murphy, 1990b; Lazear & Rosen, 1981). Yet relative performance evaluation (which typically puts a negative incentive on rivals' performance) can induce more aggressive behavior on behalf of managers since it rewards reduction of rival or industry profits (i.e., the consequences of aggressive behavior) in addition to improvements of one's own performance. Such aggressive behavior may be beneficial in contexts of preemptive competitive interactions; however, where reciprocating interactions occur (Salas-Fumas, 1992), firms would benefit from using incentive systems that reward managers for superior industry profitability while deemphasizing own-firm deviations from industry performance to penalize aggressive behavior.<sup>7</sup>

There is some empirical evidence supporting the view that incentives that put a negative weight on average industry performance make firms more aggressive in competition, whereas incentives that are based on absolute performance or that put a positive weight on average industry performance encourage competitive accommodation and deescalation. In a large sample of U.S. CEOs, Aggarwal and Samwick (1999) found positive compensation sensitivity to the performance of rivals. The ratio of own-firm to rival-firm pay-performance sensitivities decreased as industries became more competitive. The evidence was consistent with deemphasizing own-firm performance to deescalate rivalry. Similarly, Joh (1999) found that own-firm performance was deemphasized relative to industry performance in Japanese industries with less growth and less concentration (i.e., when competition is likely to be intense).

*Market-share-based incentives.* Incentives based on market share are fairly common in industries such as automotive, investment banking (Ritz, 2008), and telecommunications (Parker, 2010) and have typically been adopted by firms aiming to defend, gain, or regain powerful market positions. In principle, incentives based on market share combine two previously discussed characteristics: They focus on volume or revenue in addition to profits and provide relative performance evaluation with strictly negative weights on rivals' volume or revenues (since market shares add up to a fixed 100%). Therefore, market-share-based incentives, by design, lead to aggressive competitive behaviors (T. Jansen, Lier, & van Witteloostuijn, 2007). Consequently, market-share-based incentives are more effective in contexts of preemptive competitive interactions where aggressive actions will dissuade rivals from commitments and encourage them to take a more passive competitive position.<sup>8</sup>

*Incentives based on corporate versus divisional performance.* Depending on the nature of intrafirm spillovers, corporate-wide or divisional incentives may lead to more aggressive divisional behavior (Fauli-Oller & Giralt, 1995; also see Barcena-Ruiz & Espinosa, 1999). Under positive intrafirm spillovers such as shared technological benefits, scale economies in joint activities, scope economies, or technological, distribution, or marketing synergies, corporate-wide incentives encourage divisions to look beyond their parochial interests and provide greater incentives for cooperation (Govindarajan & Fisher, 1990; Hill, Hitt, & Hoskisson, 1992). In those situations, additional volume and market presence by one division benefits sister divisions since it facilitates coverage of joint costs and utilization of joint activities. Thus, divisional managers with corporate-wide incentives would be willing to be more competitively aggressive than if their incentives were purely divisional, particularly when the joint benefits are based on cost reductions. Therefore, under positive spillovers, corporate-wide incentives make managers more competitively aggressive. This pattern of delegation may be beneficial in contexts of preemptive competitive interactions (Fauli-Oller & Giralt, 1995). In contrast, divisional incentive systems will commit divisions to less aggressive competitive behavior, which may be beneficial in contexts of reciprocating competitive interactions.

The opposite predictions emerge when divisions experience negative interdivisional spillovers (Fauli-Oller & Giralt, 1995). For example, divisions may compete in related product markets (the Chevrolet and Pontiac divisions of GM) or use competing distribution channels (Barnes & Noble and [barnesandnoble.com](http://barnesandnoble.com)) or competing technologies (HP Laser

and Inkjet departments) to serve the same ultimate customer (Christensen, 1997; Galunic & Eisenhardt, 1996).<sup>9</sup> In those situations, the products and services of the divisions are substitutes in the market, and aggressive competitive behavior by one division could cannibalize the performance of sister divisions. In that context, corporate-wide incentives would make divisional managers less aggressive and more cautious about cannibalization threats. Divisional incentives, however, would free managers to focus exclusively on opportunities and threats for their division, without concern for cannibalization. Greater emphasis on divisional incentives among competitive divisions would therefore be beneficial in contexts of preemptive competitive interactions. For example, divisional incentives can be effective means to commit to more aggressive behavior to deter entry and preempt emerging market opportunities, along the lines of Christensen's (1997) recommendation for incumbents to create an independent division to respond to disruptive technologies. Therefore, under negative interdivisional spillovers, divisional incentives will generally make divisional managers more aggressive relative to corporate incentives since they are not accountable for the negative effects on sister divisions.

## **Integrating Strategic Delegation Into Management Research**

### *Broadening the Assumptions of Strategic Delegation Models*

Despite its extensive diffusion in economics, the strategic delegation perspective has not yet disseminated to the management literature. In our view, a major roadblock has been the conflict between the restrictive assumptions (both behavioral and contextual) in formal strategic delegation models and the assumptions used in management. In this section, we examine these assumptions to develop a common set of assumptions that would make the strategic delegation perspective more attuned with and more relevant to strategic management and organization theory research.

*The strategic effect of delegation should be considered along with its effects on value creation.* Models of strategic delegation assume that the firm-level parameters of value creation, including cost structure and perceived quality of products and services, are unaffected by the design of the delegation (e.g., the incentives provided to managers). Using the language of the value-based view (Brandenburger & Stuart, 1996), value creation, defined as the gap between willingness to pay and cost, is exogenous to the model. This resembles a situation in which managers would have no discretion on value creation activities but could choose how firms should appropriate value (e.g., how the value is split between customers and the firm by setting price and adjusting competitive behavior). This is a useful assumption that helps the modeler to "isolate" the strategic effect of the delegation choices. It is rather striking, for example, that, under strategic interdependence, a sales-maximizing manager could obtain higher profits for his or her firm, relative to profit-maximizing rivals, even when all firms have the same cost structure (see Fershtman, 1985).

On the other hand, exogeneity of value creation to managerial decision making is a largely unrealistic assumption that is in stark contrast with organization theory and organizational economics. Managers often select among investments that require trade-offs

among fixed costs, marginal costs, and customer's willingness to pay. For example, managers may decide whether to invest in a technological innovation that increases fixed costs but reduces marginal costs or whether to increase the quality of raw materials that could increase willingness to pay but also raise marginal costs. Accordingly, the work on agency theory and corporate governance emphasizes incentives as a motivation for managers to engage in value creation activities (or to avoid activities that destroy value) that are not visible to the principal (Eisenhardt, 1989; Kerr, 1975; also see Dalton et al., 2007, for a review). More recently, seeing market interaction as an "active search for value creation and appropriation opportunities" (Brandenburger & Stuart, 1996: 7), strategy scholars have begun examining the endogenous link between value creation and value appropriation by focusing on conditions for a firm to appropriate value (MacDonald & Ryall, 2004), the role of demand in pursuing sustainable advantage (Adner & Zemsky, 2006), the choice between generalist and specialist strategies (Chatain & Zemsky, 2007), and heterogeneous resource complementarity in strategic factor markets (Adegbesan, 2009). Thus, extant research highlights that value creation is in fact endogenous to managerial action.

Therefore, it is necessary to move from isolating the strategic effect of delegation into integrating it with its effects on value creation. Although a few exceptional studies took a step in this direction (Ishibashi, 2001; Szymanski, 1994; Z. Zhang & Zhang, 1997),<sup>10</sup> strategic delegation models still lack a systematic integration of value creation objectives, and the existing management literature fails to address the strategic effects of delegation. This is an important extension because there is an inherent trade-off between value creation and value appropriation effects of delegation instruments. As mentioned earlier, mixed incentives that partially emphasize sales or revenue maximization reduce managers' sensitivity to cost and increase their sensitivity to volume. Managers with mixed incentives may then underemphasize cost containment because such activity would carry a personal disutility of effort or simply not be consistent with the measures and rewards in place. Consequently, although the firm might gain from strategic manipulation of rivals' competitive responses, it might lose from reduced control over costs—especially in settings where managers can affect (via bargaining and/or investment) the cost structure. These considerations imply that strategic delegation would be most effective when managers have greater influence over competitive actions than over value creation choices. When managers have high levels of influence over value creation, then strategic delegation would require a more nuanced approach that could incorporate multiple performance measures to let managers with superior knowledge determine the appropriate course of action when balancing value creation and value capture opportunities.

*The risk preferences and career concerns of managers to whom decision making is delegated should be taken into consideration.* Strategic delegation models depict managers to whom the decisions are delegated as rational, risk-neutral agents (i.e., they are indifferent to the level of risk involved in their strategic decisions) who take actions to optimize their personal utility from the incentive structure given to them. This is consistent with the common assumption that professional managers specialize in decision making and investors specialize in risk taking. However, both parties may actually be concerned about unsystematic (firm-specific) risk (see Gray & Cannella, 1997; Wiseman & Gomez-Mejia, 1998). If managers are actually risk averse (rather than risk neutral, as assumed in the strategic delegation literature), then they may choose to actively mitigate risk where environmental

uncertainty is high, leading to potential conflicts of interests with investors. Accordingly, a common problem underlying most principal–agent models is the trade-off between incentive alignment and risk shifting to a more risk-averse manager, particularly since managers cannot easily diversify their employment and compensation risks (Eisenhardt, 1989). The traditional agency theory solution to these conflicts is to design incentive systems that align the interests of principals and their agents by increasing the sensitivity of the agent's reward to the outcome of the principal or to the economic performance of the firm (although constrained by the negative effect of risk shifting to agents; Dalton et al., 2007; Eisenhardt, 1989; S. Ross, 1973). Empirical studies have shown that managerial incentives do affect firm risk taking (e.g., Beatty & Zajac, 1994; Wright, Kroll, Krug, & Pettus, 2007).

These considerations are important in the context of strategic delegation because providing strategic incentives that differ from profit maximization may further influence the risk exposure of managers to the uncertain consequences of their actions. Then, when given incentives that reward aggressive competitive behavior, risk-averse managers might be more likely than their risk-neutral counterparts to deviate from their incentives and to deescalate the competition.<sup>11</sup> In fact, experimental evidence is largely in line with this latter prediction, showing that, when competitive interactions are preemptive, competitive outcomes under mixed incentives are significantly more cooperative (less competitive) than the formal strategic delegation models predicted (Huck, Muller, & Normann, 2004; Raab & Schipper, 2009).<sup>12</sup> These considerations and experimental results highlight that incentives might not be the only determinant of competitive behavior and managers do not blindly escalate competition in response to strategic incentives. Therefore, it is important to take into account the risk preferences of managers in examining the strategic effects of delegation.

A potentially valuable extension is to go beyond explicit incentives (e.g., profit-only vs. mixed incentives) and predispositions (e.g., manager type) and take into account implicit incentives and career concerns of managers, such as termination or promotion. For instance, Matta and Beamish (2008) found that a longer CEO career horizon is associated with a higher likelihood of international acquisitions, but that these actions are attenuated for CEOs nearing retirement with high levels of in-the-money unexercised options and equity holdings. That suggests the latter may focus more on short-term wealth preservation while bypassing risk-appropriate opportunities. Similarly, Chevalier and Ellison (1999) found that younger managers, concerned about their careers, are more likely to imitate the sector portfolio of the average fund, thereby reducing the risk of under- or overperformance relative to peers. Thus, as a general rule, strategic delegation will be beneficial when the strategic benefits exceed the agency costs (Slade, 1998).

*Delegation can have strategic consequences whether it is purposely designed or has emerged without anticipation of its strategic effects.* Formal strategic delegation models assume that firms and owners can anticipate the strategic effect of delegation decisions and use optimal delegation practices for different competitive environments. When there is incomplete information about the rivals' characteristics, signaling and precommitment become intertwined, and models may become intractable (Green, 1991). But given that there is no uncertainty regarding demand and supply parameters and those parameters are common knowledge in these simplified models, managers know with certainty the best response

functions of their rivals (see Fershtman & Judd, 1987, for an exception),<sup>13</sup> and principals can fine-tune the governance systems to the specific (strategic) conditions of the market. Thus, in strategic delegation models, delegation decisions (i.e., selection of agents, allocation of decision rights and organizational design, and provisions of incentives) emerge endogenously and are deliberate and foresighted.

Although these assumptions simplify and make modeling more tractable, they are hardly consistent with the extant theory and empirical evidence. In reality, managers do experience uncertainty about their rivals' responses, and governance choices may be largely determined without *ex ante* explicit consideration of the strategic delegation mechanism, at least in the short term. Delegation decisions may vary because of multiple factors unrelated to competition such as structural inertia, seniority policies, or institutional factors. They can be driven by firm performance (Cannella & Lubatkin, 1993), strategic orientation (Boyd & Salamin, 2001), organizational culture (Van den Steen, 2010), or industry characteristics (Datta et al., 2002), and can vary across countries. It is also possible that, in the long term, if particular forms of delegation provide strategic advantages in competition, certain patterns of delegation may become institutionalized in particular competitive environments. For instance, the period of growth of the global petrochemical industry produced a generation of managers whose project evaluation criteria were based on "you can't do any wrong as long as you build" (Bower, 1986: 38) and, hence, strategic incentives in this industry evolved toward aggressive pursuit of market share or capacity. Thus, given the complex nature of governance systems, we cannot automatically assume that delegation decisions are made in full anticipation of their competitive effects. Delegation choices can be deliberate (intentions realized) or emergent (patterns realized despite or in the absence of intentions; Mintzberg & McHugh, 1985).

A pertinent question, then, is whether the strategic effect of delegation instruments depends on whether they are deliberate or not. It is possible that, like performance effects of purposive and unintended multimarket contact (see Gimeno, 2002), delegation can have strategic consequences even under a weak anticipation assumption: that delegation practices are exogenously determined and therefore firms do not anticipate the competitive effects of their delegation choices. This is especially so when delegation decisions are not easily reversible, either because of investment and organizational costs involved such as creating or dissolving divisions in a multidivisional firm or because of institutional constraints like legal requirements for shareholder voting to change top management compensation schemes in publicly traded firms. In such situations, particular organizational design instruments (e.g., structure, compensation) will be in effect for a duration (yielding a commitment value) and will constrain and shape firm behavior. With repeated interaction, rivals can anticipate one another's best response functions and delegation can lead to strategic outcomes (Fershtman & Kalai, 1997), even though delegation emerged exogenously. Furthermore, firms with different delegation schemes interact in the product market and competitive interaction rewards some forms of delegation over others. As a result, survival rates of firms may be affected by their delegation schemes, leading to differential selection (van Witteloostuijn, 2003). Taken together then, delegation decisions may indeed provide insights and yield strategic outcomes even when they are not designed in full anticipation of their competitive consequences.

*Observability, irreversibility, and credibility of delegation instruments should be treated as contingencies.* Formal models of strategic delegation assume that incentive contracts serve as credible, binding commitments because they are explicit, common knowledge (i.e., they are observable to rivals), and in force for a substantial amount of time (Fershtman et al., 1991; Fershtman & Judd, 1987; Green, 1991; Katz, 1991). These are important assumptions, particularly in one-time interactions, without the opportunity for mutual learning among rivals (Katz, 1991). Since the strategic delegation mechanism acts by influencing the behavior of rivals, the strategic effect is unlikely to occur in a one-shot situation if firms are not aware of their rivals' incentive systems, or if they consider these incentive systems to be nonbinding (e.g., if the firm could signal that it will reward aggressive behavior to deter or discourage rivals, yet secretly reward profit maximization).

Management research, on the other hand, tends to treat the observability and credibility as a contingency in the model, not as an assumption. For example, Greve (2008) examined imperfect observability as a condition for the realization of the mutual forbearance effect. The research on adoption and mimetic behavior has also been linked to observability (Greve, 1998). Perhaps most directly, competitive dynamics research examined firms' awareness to how cognizant a focal firm is of its competitors, the drivers of competition within the industry, and the general competitive environment, because it affects the extent to which a firm understands the consequences of its actions within the competitive landscape (Chen, 1996). Awareness is shown to vary with several organizational characteristics, such as the age of the firm, the diversity of markets in which it competes, and top management team (TMT) demographics (see Smith, Ferrier, & Ndofor, 2001, for review).

Assumptions about observability and credibility of delegation instruments, though restrictive, do not invalidate the strategic delegation perspective but highlight that the validity of these assumptions depends on the type of governance dimension being studied (Fershtman & Gneezy, 2001; Fershtman & Kalai, 1997). First, certain instruments are public or semipublic and, hence, observable. For example, compensation, stock grants, and stock options for top managers are visible to outsiders for publicly traded companies in the United States, according to SEC regulations (Reitman, 1993; Spagnolo, 2000).<sup>14</sup> Structural arrangements, such as strategic separation of vertical units, creation of cost, revenue, or profit centers, or creation of semiautonomous divisions, are probably semipublic. Implementation of major incentive plans may also be semipublic. Although firms are not required to disclose them, strong institutional pressures for adoption and disclosure exist, particularly if they are profit maximizing (Westphal & Zajac, 2001). For example, firms typically publicly announce their stock repurchase plans or adoption of value-based management systems since those adoptions may signal a shareholder value orientation that will be welcomed by capital markets. Second, even when delegation instruments are not directly observable, the pattern of action may reveal organizational commitments in repeated interaction. When incentives are stable and interaction is repeated, as we mentioned above, the first interactions among agents provide information about firm behavior from which incentives may be inferred (Fershtman & Kalai, 1997). Furthermore, when incentive systems apply to multiple managers, the reputation spillover across activities may make these incentives more stable and credible (Corts & Neher, 2003). Therefore, even without direct observation, incentive and governance systems may modify rivals' behaviors as they learn

about the manager's competitive behavior. Taken together, these considerations highlight that observability, irreversibility, and credibility of (explicit) delegation instruments should be considered as contingencies in strategic delegation models.

In addition, the role of implicit incentives as credible commitment devices may incorporate a potentially valuable extension as well. Although some incentives may not be formally stated in compensation packages, they may still be implicitly reinforced through subjective performance evaluations and career promotion practices (Gibbons, 1998). Information about implicit, self-reinforcing incentives may be sought from public information about the culture and goals of the company. For instance, General Electric's goal of being number one or two in its markets and Procter & Gamble's formal competitive brand management structure make implicit credible commitments to some subjective evaluations of managerial performance that are observable by rivals. The implicit nature of such incentive systems may enhance their credibility as commitments since changing implicit contracts is difficult and costly.

*Costs of commitment should be taken into account.* At the heart of strategic delegation lies precommitment to a given course of action through delegation of decision making to managers whose incentives diverge from that of principals. By credibly committing to a given course of action, a firm can influence the optimal competitive decisions (i.e., the best response functions) of its rivals. Delegation without commitment value (when managers have no discretion over competitive actions) might affect firm decisions and performance but will not have the "strategic" effect that is central to the strategic delegation literature.

Yet the benefit of credible commitment to a strategy in the long run is not always straightforward because commitment, by definition, comes at a loss of flexibility. It is important to understand the long-run competitive influence of commitment decisions and which actions are going to be challenged by competitors and which are not (Chen & MacMillan, 1992) because the commitment value arises only when favorable long-term benefits through shifts in competitors' behavior exceed short-term efficiency losses. This is a challenging task because strategic and nonstrategic decisions are frequently made under uncertainty about market conditions, cost, and competitors' goals. When uncertainty is present, the value of commitment will be questionable since firms will want to adjust to new contingencies. Inability to adjust and fine-tune to these new emerging contingencies may result in significant losses (Scialdone, 2007; Trigeorgis, 1996). The value of options relies on the ability of firms to react and tailor new strategies. Whenever the environment brings significant changes, a flexible firm will outcompete a committed rival, since the committed rival will not be able to adjust (or will adjust only after incurring significant costs). Hence, firms that aim to be open to exploration and exploitation might be better off with flexible organizational structures, oscillating, for example, between centralization and decentralization of decision making (Siggelkow & Levinthal, 2003).

In strategic delegation, as is the case in any situation of commitment, decision makers face a trade-off between the value of commitment and flexibility. In the case of strategic delegation, the trade-off is between the increase in the firm value as a result of commitment to long-term objectives, which is the strategic effect emphasized in the strategic delegation models, and the marginal loss in firm value as the result of increased competitive response from rivals, which

is driven by the focal firm's insensitivity to rivals' strategic maneuvers in the short run (Barcena-Ruiz & Espinosa, 1996). Therefore, it is likely that managers will be compensated both on long-term objectives to commit credibly to the desired course of action and on some myopic objectives to increase the aggressiveness of the manager to reduce the firm's vulnerability to short-run rivalrous actions (Goering & Harikumar, 1999). A testable prediction is that strategic delegation will be less effective in contexts where environmental uncertainty is high than in relatively more stable contexts (Fershtman & Judd, 1987).

These considerations also imply that strategic delegation models, as well as the work on organizational control and governance systems, might benefit from opening up to theories of individual and organizational learning. As managers learn over time how to be more productive under a given incentive regime—as well as how to exploit it (Obloj & Sengul, 2011), the link between governance systems and realized strategies may evolve, and the strategic value of delegation systems may change, too, even when there is no uncertainty in supply and demand parameters and even when delegation systems remain unchanged.

### *Linking Strategic Delegation to Theories of Management*

Strategic delegation models provide a fresh approach to competitive dynamics and the question of designing effective organizational controls and could contribute substantially to the theoretical and empirical literature of strategic governance and control systems. Below, we explain ways in which the strategic delegation perspective can be linked with existing theories of management.

*Organizational control systems.* Strategic delegation theory should rekindle interest in and add value to the literature on strategic versus financial controls (Collis, Young, & Goold, 2007; Goold & Quinn, 1990; Kaplan & Norton, 1996). Prior research showed that excessive financial controls led to unwillingness to invest (Hayes & Abernathy, 1980) or to commit to innovative strategies (Hoskisson et al., 1993). Strategic delegation theory provides a more fine-grained understanding of these outcomes as it suggests that some competitive conditions may render financial controls ineffective. It also suggests some appropriate alternative incentive and governance systems to shape competition in the desired direction. Value-based management systems (see D. S. Young & O'Bryne, 2000), for example, may be beneficial for achieving efficient resource allocation or for encouraging reduced aggressiveness in contexts of reciprocating interactions; but they may lead to ineffective strategies when competitive interactions are preemptive or when entry prospects are high. Event studies that evaluate stock price responses of rivals to the announcement of value-based strategies could reveal whether these effectively signal to (and are interpreted by) analysts as an intention to pursue less aggressive competitive behavior in oligopolistic markets. Likewise, similar studies could evaluate whether the market rewards entire industry segments on the announcement of a value-based incentive system by any one particular firm.

In addition, the strategic delegation perspective can be integrated with strategic control theory (Eisenhardt, 1985; Ouchi, 1979), which emphasizes that organizational systems and processes significantly vary across firms practicing outcome controls (i.e., monitoring

results) and behavior controls (i.e., evaluating actions). Strategic delegation models may be more effective under certain strategic conditions that favor outcome controls, such as in stable and predictable industries (Ouchi, 1979) or firms that have a large span of control (Baysinger & Hoskisson, 1990). Furthermore, the use of outcome controls (as opposed to behavioral controls) can be motivated by asymmetric information between principals and agents, or by monitoring costs—both of which are exacerbated by the strategic aspect of delegation decisions.

*Organizational structure.* The strategic delegation perspective calls for attention to a firm's own and rivals' organizational structure in formulation and execution of competitive strategies. This is, in fact, a familiar approach to both practitioners and scholars of strategy. More than 30 years ago, Porter (1980: chap. 3) mentioned that in assessing a competitor's present and future goals it is necessary to understand, in addition to other dimensions, what a competitor's organization structure is, how this structure allocates responsibility and power, what control and incentive systems are in place, and so on. This competitor analysis framework, and its variations, is still in use today, in both practice and teaching (see, e.g., Coughlan, 2002). Yet the strategic aspect of rivals' organizational choices has been ignored in theoretical and empirical research on competition and strategy (see Keats & O'Neill, 2001, for a review of organizational structure from a strategy perspective). Strategic delegation theory highlights the importance of rivals' governance systems and organizational structure on a firm's decisions pertaining to its own structure and strategy and, as we have reviewed, lays out explicit predictions as to how internal organizational choices of firms will affect external (i.e., product market) competition between them.

The strategic delegation perspective also provides a fresh approach to the strategy–structure link in multidivisional firms. It is now canon that the appropriate fit between a strategy, structure, and control system is associated with superior performance in multidivisional firms (Hill et al., 1992; Olson, Slater, & Hult, 2005). Overdiversification, especially in the presence of poor governance systems, may result in loss of strategic control (Hoskisson & Turk, 1990). Therefore, it is necessary to take into account the nature of interdivisional spillovers. Hill and his colleagues (1992), for example, showed that diversified multidivisional firms will benefit more from cooperative organizational arrangements when they attempt to realize economies of scope but more from competitive arrangements when they attempt to realize economic benefits from efficient internal governance. Strategic delegation extends this research stream by showing that optimal structure and incentives are also contingent on the competitive context between firms (Fauli-Oller & Giralt, 1995). For example, a firm competing in contexts of reciprocating interactions (where less aggressive action is sought) may choose strategically to maintain autonomy among divisions even though there may be some positive interdivisional spillovers to avoid escalating competitive interaction. This type of effect is potentially more observable in industries where several chains and franchisees operate simultaneously, as would occur in the hotel industry.

*Strategic leadership.* Strategic delegation adds a strategic commitment dimension to strategic leadership research, in particular to selection of managers and to executive

compensation. The extant research has shown that managerial background characteristics (such as age, tenure in the organization, functional background, education, socioeconomic roots, and financial position) might affect managers' dispositions and, consequently, their decision making (see Finkelstein et al., 2008, for a review). The research has also shown that the fit between firm strategy (e.g., prospector vs. defender, build vs. harvest) and manager experience and orientation has a positive impact on firm performance (Gupta & Govindarajan, 1984b; Thomas et al., 1991). Extending these studies, strategic delegation models encourage the empirical examination of how such choices affect rivals' competitive behavior and, ultimately, industry competition. Exploration of these issues would encourage the complex task of linking internal incentive and control systems to more externally oriented competitive behaviors.

The research on managerial discretion can also be linked to strategic delegation models. This is an important construct for strategic delegation models because, as we noted above, within-firm delegation (from corporate executives to business unit managers) would affect competitive interaction (i.e., have the strategic delegation effect) if and only if business unit managers have discretion over competitive decisions and their discretion is visible to rival firms. Although managerial discretion can be driven by the task environment, internal organization, and/or managerial characteristics, what is particularly pertinent to strategic delegation models is the influence of market growth, demand instability, and especially industry structure (oligopoly vs. monopolistic or perfectly competitive industries; Hambrick & Finkelstein, 1987). In an interesting study, Hambrick and Abrahamson (1995) explored managerial discretion in a number of four-digit Standard Industrial Classification industries and found significant variation across industries. A relatively straightforward extension of this research to strategic delegation would be to examine whether and how managerial discretion is correlated with the nature of competitive interaction (reciprocating or preemptive) in these industries.

*Competitive dynamics.* Strategic delegation theory encourages linking internal organizational design and control systems to more externally oriented competitive behaviors. Competitive dynamics research, like most approaches in organizational economics and strategy, adopts a unitary actor assumption: Relevant actors are firms carrying out competitive actions, and each takes competitive decisions as a single decision maker. To be sure, TMT characteristics, such as TMT size, experience, tenure, and heterogeneity, influence competitive actions (see Smith et al., 2001, for a review). Yet beyond these characteristics, there are no internal frictions in this research stream, and organizational structure and control systems have not been taken formally into account.<sup>15</sup> The sole exception is structural complexity, measured by the number of organizational levels and departments an organization has relative to its total size. Bureaucracy and standard operating procedures hamper structurally complex firms and thereby diminish the firm's ability to act and respond to competitive challenges (Smith, Grimm, Gannon, & Chen, 1991).

The strategic delegation literature brings the organizational design and control systems within firms directly into the study of competitive interaction between firms. It highlights that these parameters can be endogenous—not only to environmental or industry factors or value creation concerns but also to strategic consideration. Hence, strategic delegation theory

offers a number of interesting and promising extensions to the existing research on competitive dynamics. A first is to examine heterogeneity in competitive action–response patterns across owner-operated and manager-operated firms, similar to Slade (1998), Corts (2001), and Vroom and Gimeno (2007), to examine whether there will be systematic variation in competitive behavior and performance across these firms, depending on the nature of the competitive interaction in the industry. It will also be valuable to examine organizational design parameters such as incentive systems, vertical separation, and/or authority structure as antecedents of competitive action. If organizational design parameters are endogenously determined and common knowledge, as assumed in the strategic delegation literature, both organizational design and competitive interaction might evolve over time. Depending on the competitive context, competitive interaction can be more or less pronounced than the competitive dynamics literature would normally predict. Thus, it will also be necessary to examine the effect of organizational design parameters on competitive activity, conditional on the organizational design parameters of rivals.

*Business model competition.* The strategic delegation approach can also be extended to the firms' business model choices (see Zott, Amit, & Massa, 2011, for a review). In some industries strategic homogeneity is high and firms adopt similar business models. In these industries, firms are likely to make delegation choices that conform to their industry's central tendencies (Y. Zhang & Rajagopalan, 2003). In other industries, especially those that are prone to dominant designs and/or standards, competing firms' business models may provide different revenue models (such as open-source vs. proprietary technology), and those might be associated with different organizational objective functions and governance mechanisms (Almirall & Casadesus-Masanell, 2010; Casadesus-Masanell & Yoffie, 2007). For example, models that are funded by advertising or by revenues from complements (e.g., Google's Android) may involve more aggressive competitive behavior in pursuit of a large installed base, which will affect competitive interactions. On the other hand, a revenue model based on capturing margins on hardware (e.g., Apple's iPhone) will be less aggressive competitively, and may induce deescalation by competitors. In these situations, strategic delegation can accentuate the different objectives embedded in the different business models.

### *Additional Avenues for Empirical Research*

Understanding the true value of strategic delegation research for the management field requires targeted empirical research, which remains a nascent area for strategy scholars. In this section, we introduce a number of empirical research avenues, in addition to those that we mentioned in previous sections, that we see as potentially promising.

*Main model.* A foremost empirical opportunity lies at the core of the theory of strategic delegation, in which firm performance is a joint function of governance systems and competitive interactions. Although there is some empirical evidence in support of the general strategic delegation model, existing studies are scant and generally rely on indirect measures of strategic delegation instruments, in particular the ownership structure (Corts, 2001; Slade,

1998; Vroom & Gimeno, 2007). Although ownership is an important form of corporate governance (Connelly, Hoskisson, Tihanyi, & Certo, 2010), additional studies that examine the strategic effects of the use of other, more direct measures of delegation instruments are needed. For example, cross-sectional evaluation of how alternative components of incentive packages—such as bonuses determined by sales, profits, market share, cost reduction, or quality or the use of stock, restricted stock, stock options, or gain-sharing payments or other means of rewarding managers—vary in conjunction with the competitive contexts would also be important contributions to the strategic delegation literature. In addition, as organizational design involves multiple interdependent elements (Rivkin & Siggelkow, 2003), the strategic effects of the use of multiple delegation instruments (Etro, 2011; Vroom, 2006) remain a promising empirical research opportunity.

*Interindustry heterogeneity.* The strategic effects of delegation instruments can vary across industries because of several industry characteristics (in addition to the reciprocating vs. preemptive nature of competitive interactions). For example, industry growth stage may lead to varying incentives and management selection (Hambrick & Finkelstein, 1987; Kerr, 1982). When an industry is in an early life-cycle stage, demand outstrips supply and firms may pursue sales-oriented incentives to build volume and market share and preempt others from occupying the opportunity. Alternatively, in a mature industry, profit-oriented incentives may be more prevalent to soften competition. Accordingly, strategic delegation may also be incorporated to shape behaviors in response to an evolving industry structure. For example, where consolidation may have created an oligopoly from a previously fragmented industry, a shift toward profit-based incentives rather than revenue-oriented incentives may serve to reorient the priorities within firms as well, signaling a new intent in regard to interfirm rivalry. Acquisitions by leveraged buyout and private equity firms may also be instrumental in changing the objectives in the industry from growth to profit focus (Chevalier, 1995).

*Intraindustry heterogeneity.* Separately, intraindustry heterogeneity should be examined. These types of studies, however, will require industry-specific longitudinal samples, rather than the multi-industry cross-sectional samples common in governance research. One source of variation in firms' choices of strategic delegation instruments is their relative market shares: Firms within an industry might adopt different incentive structures in anticipation of strategic effects based on their relative market share. For example, in highly concentrated industries where cartelization is plausible, softer competitive behavior characterized by profit-oriented incentives could be anticipated. This might be particularly apparent among large-market-share firms that stand to benefit disproportionately from such competitive actions (Greve, 2008). Alternatively, smaller share firms, which may benefit disproportionately by defecting from cartel behavior through aggressive actions, might choose more sales-oriented incentives, especially when their incentives would not be expected to be visible to competitors. Another interesting extension will be to examine variation within and across strategic groups within industries (see Barney & Hoskisson, 1990, and Dranove, Peteraf, & Shanley, 1998, for critical reviews). Since firms within the same strategic groups follow similar strategies and engage in more direct competitive interactions, strategic effects of delegation would be more pronounced among firms belonging to the same strategic groups.

The intraindustry heterogeneity of firm objectives constitutes yet another promising empirical research avenue. In “mixed oligopoly” settings, owner-operated private firms, publicly traded firms, not-for-profit firms, and state-owned firms compete within a single industry but pursue different objective functions (Casadesus-Masanell & Ghemawat, 2006; Purroy & Salas, 2000). Consider, for example, the health care, education, and transportation sectors. In the strategic delegation literature, a number of formal studies have already examined mixed oligopoly settings and found results largely consistent with the general model of strategic delegation (Barros, 1995; Goering, 2007; Nakamura & Inoue, 2009; White, 2001). For example, Purroy and Salas (2000) showed that firms that have a preference for size over profits may achieve lower effective marginal costs than their profit-maximizing rivals and outperform them in market share and profits in the context of preemptive interactions. Empirical studies that examine whether, how, and under which conditions delegation instruments yield strategic outcomes and how these outcomes vary across firms that pursue different objective functions will be particularly informative.

*International differences.* Global competition emerges as a natural empirical context to test strategic delegation models since it puts firms in direct competition with firms that have very different governance systems. A promising research avenue is the variation in delegation instruments across subsidiaries in multinational enterprises (MNEs). For example, strategic incentives given to a subsidiary might depend on its role within a multicountry network of its parent MNE. An MNE can see its subsidiary in a given host country as a profit, growth, or learning center (Mudambi & Navarra, 2004), and hence the subsidiary might pursue different objectives, and adopt different strategic incentives, than local firms and other MNEs. These different objectives would affect competitive interactions and firm performance.

Separately, the strategic use and effectiveness of delegation instruments may vary across host countries. MNEs are more likely to engage in competitive moves and/or to make resource commitments in host countries with nondiscriminating institutions and trade policies (Yu & Eden, 2001), with institutions similar to their home country (similar cultural or legal context; Yu & Cannella, 2007), or with strong ties to their home country (home–host dependence, immigration links; Rangan & Sengul, 2009) because they can more confidently operate in these settings and protect their investments. This suggests that, for subsidiaries of an MNE, strategic delegation will be more effective in host countries with similar institutions and greater ties to its home country.

Finally, another promising research avenue is international comparison of governance systems across firms from different countries and institutional systems. For instance, comparisons of incentive systems between Japanese and U.S. companies suggest that Japanese managers emphasize market growth and market share more than American managers. U.S. managers, on the other hand, excessively focus, in relative terms, on financial objectives, making their firms less willing to commit to markets under conditions of uncertainty (Doyle, Saunders, & Wong, 1992; Hayes & Abernathy, 1980). That observation, together with the strategic delegation perspective, would suggest some industries where Japanese firms would perform better (where competitive interactions are preemptive) and some industries where American firms would perform better (where competitive interactions are reciprocating).

## Conclusion

Strategic delegation theory provides a promising bridge between theories of competitive interaction and theories of organizational design and incentives. Most theoretical development on competitive interaction in strategy and economics has adopted a unitary actor assumption (where the firm is acting as a single, rational actor) and tends to ignore the complex reality of intraorganizational structures, incentives, and processes that shape many organizational choices. In contrast, these issues have been a central tenet of the research on the design of delegation instruments, more generally governance systems, in organization theory, organizational economics, and strategy. These studies in turn, however, are internal looking and tend to ignore the dynamics of competitive interaction between firms. Strategic delegation theory provides a fresh approach in that it emphasizes how delegation instruments, more generally governance systems, induce or constrain externally oriented (i.e., competitive) actions whose impacts are contingent on the response of current or potential rivals. Since managers, acting as agents of the firm, take competitive actions in most organizations, delegation instruments (such as organizational structures, task design, explicit and implicit incentives, and management assignments) shape the dynamics of competitive interaction and its outcomes. This is an important insight that has failed to make a mark on the strategy and management literature.

As strategic delegation theory implies a contingency view between delegation instruments and competitive context, it has the potential to contribute substantially to the theoretical and empirical management literature. We have highlighted, in the preceding pages, several ways in which the strategic delegation perspective can be linked with theories of management and lay ground to promising empirical research avenues. Overall, strategic delegation theory holds promise to make three main contributions to management theory and practice. First, the theory predicts that the effectiveness of different delegation instruments should be contingent on the competitive context of the firm rather than merely the internal context. This implies, for example, that delegation instruments that perform well in some oligopolistic contexts that reward aggressive commitments may backfire in other oligopolistic contexts. Therefore, studies linking organizational processes and managerial decision making to performance need to pay attention to the industry context and particularly the market structure and type of competitive interaction. Second, the prevalence of delegation instruments would vary among different competitive contexts, either because those are purposefully adopted by principals or because of an evolutionary selection advantage. For example, firms during the growth stage of industries may select managers with an optimistic or aggressive bias since that bias is reinforced by preemptive interactions. Finally, the theory suggests that changes in delegation instruments by one firm would affect the competitive behavior and performance of its rivals. This cross-rival effect suggests that delegation decisions have an effect not only on internal efficiencies but also on competitive interactions.

## Notes

1. But see Vickers (1985) and Sen (1993) for entry deterrence in monopolies through strategic delegation.
2. In the industrial organization economics literature, reciprocating interactions (where competitive responses are in the same direction) are typically referred to as *strategic complements* and preemptive interactions (where

competitive responses are in the opposite direction) as *strategic substitutes* (see Bulow, Geanakoplos, & Klemperer, 1985; Fudenberg & Tirole, 1984). However, other terminologies also exist (e.g., Smit & Trigeorgis, 2004). In game-theoretical models whether competitive interactions are preemptive (in strategic substitutes) or reciprocating (in strategic complements) is determined by the slope of the best response function of a firm's actions relative to its rivals' actions. Preemptive competitive interactions have a negative slope since an increase in rivals' aggressive activity reduces the incentive to engage in aggressive actions. Reciprocating competitive interactions have a positive slope since the best response to rivals' aggressive actions is to also undertake aggressive actions. More technically, when the profit of a firm  $i$ ,  $\pi_i(x_i, x_{-i})$ , depends on the strategic actions of a firm  $i$  and its rivals ( $x_i$  and  $x_{-i}$ , respectively), the cross-derivative of profits relative to own and rival actions is negative ( $\partial^2\pi_i/\partial x_i\partial x_{-i} < 0$ ) in preemptive interactions and is positive ( $\partial^2\pi_i/\partial x_i\partial x_{-i} > 0$ ) in reciprocating interactions.

3. This is akin to "matching" responses in the competitive dynamics literature, where a firm responds to the competitive action of a rival by duplicating the same action (e.g., responding to a price cut by a rival by cutting its own price; Chen & MacMillan, 1992).

4. A fourth category is the choice of financial structure (Brander & Lewis, 1986; see Kovenock & Phillips, 1995, and Maksimovic, 1995, for reviews). At the core of these studies lies the limited liability effect: Because a firm is the residual claimant to profits but is only limitedly liable for losses and because limited profits will be of no value if the firm cannot cover the indebtedness, managers of a heavily indebted firm try to make enough profits in the excess of the firm's debt, thereby affecting the firm's competitive aggressiveness and ultimately the competition on the product market (also see Frank & Le Pape, 2008; Povel & Raith, 2004). This is like a steep transfer price attached to capital channeled from bondholders to the firm. There is some empirical evidence in line with the prediction that a firm's capital structure can influence its investment and product-market decisions as well as those of its rivals (e.g., Chevalier, 1995; Kovenock & Phillips, 1997; Phillips, 1995). Chevalier (1995), for example, found that the announcement of a leveraged buyout (LBO) by large supermarket chains increased the expected future profits of their product-market rivals and that the presence of LBO firms encourages local entry and expansion by rivals. Yet, as with other instruments of delegation, there is a trade-off between strategic effects and agency costs (Bolton & Scharfstein, 1990), and the effect of the capital structure on competitive outcomes depends both on the nature of uncertainty (i.e., demand vs. cost uncertainty) and on the nature of competition (Haan & Toolsema, 2008; Showalter, 1995; Wanzenried, 2003). Also see Brander and Lewis (1988) and Borenstein and Rose (1995) for the strategic bankruptcy effect.

5. As Fershtman and Judd (1987) explained, the overcompensation for profits can also be interpreted as an owner's tax on the manager for his or her input expenditures. This tax disciplines the manager and prevents him or her from being too aggressive in his or her pricing strategy. Thus, in reciprocating interactions, industry-wide use of incentives that commit to less aggressive actions would lead to an improvement in performance for all the industry players.

6. Gupta and Govindarajan (1984b) have provided some indirect empirical evidence showing that there is a considerable match between firm strategic behavior and incentive bonuses offered to managers. They found that managers with a "build" mandate had greater focus on sales growth, market share, and new product and market development, whereas managers with a "harvest" mandate had incentives based on return on investment and operating profits. Even though this work focused on the match between firm strategies and managerial incentives, these contingencies are in line with the predictions of the strategic delegation perspective.

7. In an oligopolistic setting, stock options, too, have a strategic implication: A manager who is compensated on stock options is likely to adopt a type of tit-for-tat strategy because his or her stock option will be "in the money" only if the stock price is over a certain threshold. Therefore, similar to issuing debt, a manager who is compensated with stock options is likely to take less aggressive competitive decisions if the rival firm does likewise but to retaliate with aggressive competitive moves (e.g., sales maximization) if confronted with overly aggressive behavior (Reitman, 1993). Furthermore, stock options reduce managers' short-run incentives to escalate competition unilaterally. A stock market with rational expectations anticipates the negative effects (e.g., of the forthcoming price or quantity war) on firms' future profitability and discounts it on stock prices as soon as the manager takes a competitively aggressive action that is prone to competitive escalation (Spagnolo, 2000).

8. Ritz (2008) argues that market-share-based incentives are more likely to diffuse within a given industry than mixed incentives. In either compensation scheme, sales by all firms rise, increasing total industry output and reducing profits. Managers will always have an incentive to increase sales with mixed incentives, but they do so with market-share-based incentives if and only if increased sales correspond to increased market share. That is

because, in a setting where all firms adopt market share incentives, increased sales will reduce the market price without changing the market share, hence without changing managerial compensation. Thus, in anticipation of such outcomes, industry-wide adoption of market-share-based incentives yields less competitive and more collusive outcomes than mixed incentives.

9. The extant literature on multidivisional firms, going back to Sloan and Chandler, is understandably built on positive interdivisional spillovers, with high resource sharing between units and limited cannibalization. Yet multidivisional firms with negative spillovers between units are also observed in practice. In addition to unintentional occurrences (because of, e.g., uncontrolled expansion or diversification), there are multiple reasons for this. In early stages of product development, when the market potential of different product designs is uncertain, firms may choose to have competing divisions to keep the option value of their initial investment (Galunic & Eisenhardt, 1996) and foster internal competition toward innovation (Birkinshaw & Lingblad, 2005). In high-velocity industries where dominant production technologies change occasionally, division with competing (new vs. old) technologies may provide a coinsurance against structure inertia (Bower & Christensen, 1996). Similarly, units adapting different distribution channels can protect the firms against disruption (Porter, 2001). Or, intrafirm interbrand competition can help firms to maintain an overall higher market share at the expense of lower margins and cannibalization (Low & Fullerton, 1994). Simply put, although negative interdivisional spillovers are not the default option for multidivisional firms, there are multiple reasons why they might arise within these firms.

10. Only three studies to date have attempted to formally link strategic delegation models to value creation activities. Szymanski (1994) showed that when input costs (e.g., labor costs) are substantial and can be influenced by managerial effort allocation (e.g., bargaining with unions), managers' incentive schemes are likely to put relatively more emphasis on efficiency and relatively less emphasis on strategic aspects. Z. Zhang and Zhang (1997) showed that strategic aspects of delegation will still be influential when managers can decide on whether and how much to invest in cost-reducing process innovation (increasing value creation), but their incentive to invest goes down when, because of weaker protection of intellectual property rights, rivals can free ride on one another's innovations (reducing value appropriation). Ishibashi (2001) showed that when managers decide whether and how much to invest in higher quality (increasing value creation), the relative importance of strategic effects will depend on commensurate increases in the cost structure and on whether investment in higher quality is associated with increasing marginal costs or increasing fixed costs.

11. A number of studies showed that collusive outcomes might be possible even in noncooperative repeated games under certain conditions (Fershtman, Judd, & Kalai, 1991; Lambertini & Trombetta, 2002; Polo & Tedeschi, 1992). For example, N. Miller and Pazgal (2002) showed that differences across firms (in terms of cost structure) make it easier to obtain a more collusive outcome. However, Salas-Fumas (1992) is the only study that exclusively focused on the risk-sharing effect (but also see Katz, 1991, for a discussion).

12. Strategic delegation models predict that firms individually benefit from using delegation practices that are aggressive (volume oriented) in preemptive interactions since aggressively committed firms would induce accommodation by rivals without such commitments. Yet like in a prisoner's dilemma situation, if multiple firms simultaneously undertake such aggressive commitments, all firms are worse off because of increased competition and, given that deviation (i.e., unilateral adoption of less aggressive action) is detrimental to firm performance in the short run, no firm deescalates the competition even though this sacrifices the opportunity to increase overall industry profits. Therefore, the diffusion of strategic delegation instruments within an industry may lead to ineffective collective outcomes even though their adoption may be rational for individual firms.

13. Fershtman and Judd (1987) suggest that, when there is uncertainty about market conditions (e.g., costs, market size, elasticity) that are visible to agents but not principals, the effectiveness of strategic delegation decreases. For instance, committing managers to a mix of sales and profit-maximizing objectives, although effective for influencing rivals, may be very inefficient if unit costs are much higher than rivals' costs. This analysis thus suggests that strategic delegation using incentives that deviate from profit maximization is more effective when there is little uncertainty about supply and demand conditions or when uncertainty is systematic for the industry (i.e., the shocks are correlated among firms). Profit-maximizing incentives are better when uncertainty is high and unsystematic (firm specific).

14. An interesting implication is that corporate governance codes, especially disclosure requirements for managerial compensation, that are introduced by governments around the world to protect shareholders against opportunistic behavior by managers (by increasing transparency) may, in certain strategic conditions, "harm

consumers' interest by offering a channel to tacitly coordinate cartel-like behavior in the product market, reducing competition and welfare" (van Witteloostuijn, Jansen, & van Lier, 2007: 897).

15. In general, this is not a shortcoming of the empirical competitive dynamics literature because most studies, while using line-of-business data, focus on settings where decisions can effectively be centralized. Consider, for example, a quasi-regulated industry such as airlines where the information on industry pricing is seen just as efficiently from a centralized location as it is from further down in the organization (Smith, Grimm, & Gannon, 1992). Similar arguments can be made for other scale-intensive industries, such as software (G. Young, Smith, & Grimm, 1996), telecommunications (Schomburg, Grimm, & Smith, 1994), and banking (MacMillan, McCaffrey, & van Wijk, 1985). On the other hand, effective centralization in other settings, like the global auto industry (e.g., Yu & Cannella, 2007), is questionable. To be sure, Yu and Cannella (2007) acknowledged the potential frictions in decision making and empirically explored mitigating factors (e.g., multinational enterprise parent's ownership of a subsidiary). Still, strategic delegation research hints that competitive dynamics research, too, might gain from more directly integrating governance systems.

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