

## ⇒ 論 説 ⇐

# Strategic Business Change with Accounting Data : the case of SMEs

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## Summary

In order to survive under the global competitive environment, even in Small and Medium-Sized Enterprises (SMEs) defines their own strategy and have done the management accounting practices for its realization. Needless to say that these are some researches for management accounting practice at SMEs, but they are just researching if SMEs adopt it or not without focusing on how and for what they adopt them. In fact, there is less discussion on the relation between the strategy implementation and management accounting.

In this paper, we examine and analyze the case of SUWADA Inc. Co., who has become a manufacturer of the high quality and high profit of nail clippers without the mechanization of the manufacturing process, as a case of successful business transformation with management accounting. We also mention that how they have been brought up skilled workers with management accounting

Keyword : Strategic Business Change, Accounting Data, Process Price, Process Cost, SMEs

## 1. Background

### 1.1 Study on the Usage of management accounting at SMEs in Japan

There are 11,000 companies (1,397 million employees) in large size and 3,853,000 companies in SMES (3,217 million employees) in Japan. Actually, 99.7% in the total number of companies are SMEs in Japan and they hire 69.7% in the total number of employees<sup>ii</sup>. However, there are not so many papers with discuss how SMEs are using accounting practice, in particular, on relationships between strategic and management accounting. Moreover, there is less discussed the

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<sup>ii</sup> Small and Medium Sized Enterprise Agency: Japan (2015) White paper on small and medium-sized businesses.

role of management accounting in the selection of the business change.

Regardless of the company size, management accounting is obviously important. Of course it takes some information cost in order to obtain the necessary management accounting information. As SMEs have less number of employees and less management resources comparing with big companies, they may be difficult to have devoted valuable human resources in management accounting and/or not so important to share the accounting information<sup>iii</sup>.

In addition, compared to the financial accounting that has been institutionalized, it has been made various efforts by companies in the management accounting field. On the practice of management accounting, there are few researches for SMEs, although there are some wide ranges of surveys for excellent companies. The number of SMEs in Japan is close to 4 million, exhaustive investigation has not been carried out so far.

## **1.2 Business challenge of Japanese SMEs and their implement of management accounting – from questionnaire response.**

One of the authors carried out questioner survey in companies who hired more than ten employees. The purpose of the investigation was to clear problems they had and to know how they solve them with management accounting. This survey carried on in three areas that were famous for the places that a lot of medium and small-sized businesses accumulate in Japan: Tsubame-sanjo, Ota-ku, Higashiosaka-shi. The period was from December 2015 to February 2016<sup>iv</sup>.

As 1739 companies were investigated in questionnaire, 169 companies returned answer (9.37%). Business challenges they faced were shown in Figure 1 (multiple answers). Among challenges that companies had, firstly 119 companies (73.01% ) chose “to ensure excellent human resources”, then, secondly 112 companies (68.71%) chose “to obtain new customers”, thirdly, 108 companies (66.26%) chose “to maintain and improve for technical capabilities, fourthly 86 companies (52.76%) chose “to keep existing customers”. This indicates that most companies regard important to ensure management resources such as human resources and technology in addition with keeping and expanding their customers number for expanding their revenue.

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<sup>iii</sup> According to Kazusa, the development of the United States of management accounting techniques has been said to be related to the development and scale of the company (1989).

<sup>iv</sup> Figure 1~2 refer to the study group report by Yamaguchi at the Japanese association of Management Accounting in 2016.

**Figure 1 Business challenge (Multiple Answers)**

	Tubame Sanjo	Ota,Tokyo	Higashi- Osaka	Total
Recruiting Top class Personnel	28	47	44	119
Finding New Customer	24	48	40	112
Technological Advancement	28	40	40	108
Retain an Existing Customer	19	41	26	86
Cost Reduction	19	16	23	58
Reduction of Manufacturing Cost	14	22	21	57
Business Succession	10	26	20	56
Research and Development	9	18	18	45
Not Heavily Rely on a Few Customers	8	13	14	35
Trying to Diversify their Business	5	11	12	28
other	0	0	1	1

Then how much deeply the respondents use management accounting? Of the respondents number 169 companies, 106 companies have been answered already introduced a management accounting (65.03%) Although there is a survey was limited to the region, it can be seen that the respondents more than 60 percent have introduced management accounting (Figure 2)

**Figure 2 : Number of SMEs Introduced Management Accounting**

	Tubame Sanjo	Ota,Tokyo	Higashi- Osaka	Total
Already introduced	28	39	39	106
Not yet	11	23	19	53
N.A.	1	2	1	4
Total	40	64	59	163

As mentioned the above, not many management work for SMEs are using management accounting in conjunction with strategies to their vision comes true. However, when we checked specifically the individual companies, not a few examples that have the practice of good management accounting

In the following chapter, we highlight how management accounting is available in implementing the strategy of business change for improving their profit level.

## **2 Prior literatures and research methods**

### **2-1 Previous research and review**

As a source of sustainable competitive advantage, a lot of analyzes had been conducted on the various strategies and the continuation and conversion of core businesses focusing on the core technology and core management resources of companies (Mishina 2007, Takai, Harada, Yamada 2011) like a Resource-based view (Wernefelt 1984, Rumelt 1974), which emphasizes the heterogeneity of management resources of individual companies such as Porter and Burney, which place importance on deciding business areas (location) by considering the external environment of the company(Poter 1980,1985, Barney 1991, 1996, Hamel and Prahalad 1990), emergent strategies emphasizing strategic accidentally (Mintberg 1994), destructive innovation theory (Chritensen 1997) and open innovation theory (Chesbrough 2006) In addition, in recent years, open source (Raymond 2001) and share concept (Porter and Kramer 2006, 2011) advocating active utilization of external resources are also advocated.

However, it is a disquisition and verification centered on large enterprises (however, Isobe (1998) is aimed at SMEs from the perspective of strategy and philosophy). Moreover, regarding the utilization of management accounting data for the strategic change in the main business, there are very few. We could find that only on case study; Toyobo co. Ltd., (Fujiwara and Aoshima 2016), but it only mentioned that the company choose factories which should be closed focusing on the marginal profit.

### **2-2 Research method**

As a research method, Semi-structual Analysis is adopted. We interviewed Ms. Tomoyuki Kobayashi, President and Representative Director of the Suwada manufacturing facility responsible for management reforms, and Kanako Kobayashi, General Affairs, responsible for preparation and utilization of accounting data, and heard the situation at the time in detail. And we also use archive data {in-house materials and published materials such as articles and journals} for this research.

**Figure 3 Interview Date, Place and Interviewee**

	Date	Place	Interviewee	Position	Time
1	2015/Jan/16	SUWADA Co.Ltd.,	Mr. Tomonori KOBAYASHI	CEO	14:00-17:30
2	2016/July/5	SUWADA Co.Ltd.,	Mr. Tomonori KOBAYASHI	CEO	14:00-17:30
3	2016/July/29	SUWADA Co.Ltd.,	Mr. Tomonori KOBAYASHI	CEO	14:00-17:40
4	2016/Aug/9	SUWADA Co.Ltd.,	Mr. Tomonori KOBAYASHI	CEO	10:30-12:30
			Ms. Kanako KOBAYASHI	CFO	11:30-13:00

### 3. About SUWADA Inc.

#### 3.1 History

SUWADA Inc., was founded in 1926 in Sanjo city, Niigata prefecture, which is famous as a metal hardware production area. The founder was a grandfather of Mr. Kobayashi who is now set out to developing pincer type clippers as a carpenters' tool.

In 1970s, when father of Mr. Kobayashi was CEO, Bonsai became a boom and bonsai scissors was selling well very much. After the boom, Kitchen tool which was a unique product specialized to peel chestnuts sold a lot. Thanks to these hit products, they could easily run company until 1990.

#### 3.2 The reason they needed business change

In 1990s, as sales of kitchen supplies that specialize in peeling chestnuts earned big profit, they invested an excessive capital to new equipment. In addition, prototype aimed at the second big hit also was made a lot. As the Japanese economy had been in recession in 1990s, sales of SUWADA also decreased but could not cost cutting. They struggled with debts stemming from rough estimation as well as the burst of economic bubble<sup>∞</sup>.

According to Mr. Kobayashi, their main bank had supported them very much because of the past hit products. Thanks to the bank, they somehow escaped the bankruptcy. Business inheritance to the third CEO was performed during business environment becoming ever

<sup>∞</sup> It was thought that the trigger of the deficit operation was an economic depression of the 1990s, but Mr. Kobayashi pointed out that the loose accounts had been their management culture and did not change since the establishment of a business of 1921. When he succeeded the company, there was a huge deficit include off balance. (Futabasya super mock,2011, p.18, upper side 1.26—downside 1. 4).

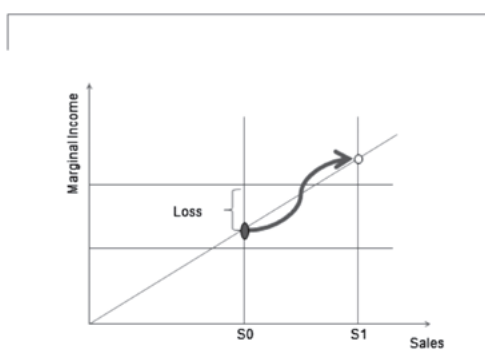
worsening. Mr. Kobayashi was said that “Despite my sales was only 3 million yen per year, there was a deficit of 60 million yen per year”. “In addition, at the time of the management takeover, hidden debt came out and its total amount was a few hundred million yen”. He told us in the third interview as “I wanted to quit to be a CEO when I knew the real business conditions”.

Labor cost violated profit when he succeeded the business. When the profit structure has stagnated or deteriorated, it is most important issues for any sized companies to cut cost, restructuring and change their business to more profitable business field. In fact, it was technique of the most orthodox management improvement to reduce labor cost dramatically. In Western companies, it is said to reduce the labor costs first for the sake of cost reduction. It meant that the labor cost had been reduced for the loss. On the other hand, in Japan, as the maintenance of employment in the top priority, companies often perform various initiatives such as relocation of employee to other business and so on to so forth. For example, when the business depression after Lehman Brothers Inc. bankrupt, NIDEC was carried out that the 10% lower salary system for one year without dismissal and TOYOTA dispatched employees to their rival companies during adjust production period.

As other big companies, Mr. Kobayashi recites that; “I would not like to dismiss for deficit. I thought that employees had no new place except here and I needed to develop skilled workers for next challenge”<sup>vi</sup>.

Therefore, he paid his attention to the nail clippers which were a high product of the earning capacity potentially to move sales amount from  $S_0$  jump to  $S_1$  without reducing the labor cost that was fixed charge (See Figure 4). In other words, the management focused on high-quality nail clippers as a next mail business.

**Figure 4 Shift Image on Marginal Income**



<sup>vi</sup> Shoko Research Institute(2011,p104,117 - 18.

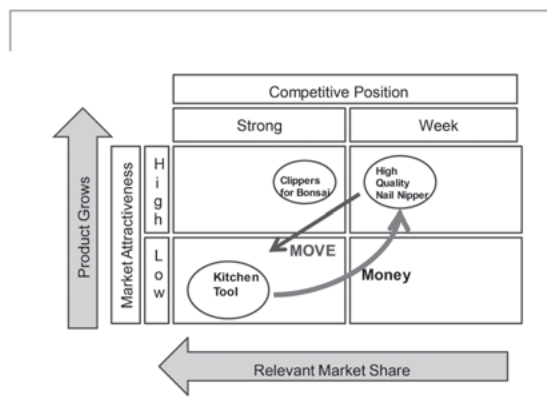
### 3.3 Business change : High quality nail clippers to the core product

As described the above, in order to improved management and increase sales dramatically without dismiss employees, the company decided to have done the business change. In other words, they regarded nail clippers as “question mark” and would be a “star” and/or “cash caw” in future, bonsai scissors regarded a “star” and kitchen tool seemed to be a “cash caw”.

As the production of high quality nail clippers needed for skilled workers, it took a long time to the training. In this sense, competitors could not be imitated their products soon. Thus the company regarded as nail clippers would generate revenue in future. Other business environment such as bonsai and kitchen supplies were highly competitive and seemed to be loose markets share sooner or later.

Mr. Kobayashi’s strategy can be expressed as follows.

**Figure 5 Strategic Business Change at SUWADA from the viewpoint of Product Portfolio Management(PPM)**



## 4 Business change and management accounting : Realization of the PPM theory

### 4.1 Setting and maintaining retail price

The company analyzed that the high quality nail clippers could become the core business as mentioned before and decided that changed business structure. In fact, they made nail clippers since the first CEO era. However, profit did not appear. Hardware wholesalers regarded a price of the nail clippers must be cheap because they were smaller, then, consumed small amount of material, thus needed cheaper material cost comparing with Bonsai scissors<sup>vii</sup>. Kitchen tool enjoyed high profit because it was a unique product specialized to peel chestnuts. As it had a

<sup>vii</sup> Yomiuri Newspaper (2014) Jan.4th,p11.

simple structure and no need to skilled workers, it was cheap to manufacture too. In other words, the nail clippers got further and further in the red as labor cost was high as it required mastery of skills and took much time. Its expecting growth rate seemed high because there was much demand, but not produced enough.

There was little quantity of production, though the production request from the demand side was very strong. Thus they were called “the nail clippers of the illusion”<sup>viii</sup>. Mr. Kobayashi thought that it made ends meet as core business if I could sell at cost plus profit equal reasonable price. To the end, it was necessary to grasp cost exactly and to hold initiative at a price.

Therefore, he exercised the maintenance of the manufacturer’s suggested retail price by choosing suppliers who keep it to sell for end users and decided build awareness of their brand. Moreover, the company needed to implement a distribution strategy based on the brand identity. Furthermore, the company had been required to increase nail clippers production with keeping high quality as soon as possible.

#### 4.2 Utilization and development of skilled workers

In order to make the nail clippers as core business was not only keeping in the suggested retail price but also improving its productivity. However large-scale production system due to mechanization could not produce high -quality nail clippers.

At first, Mr. Kobayashi showed financial statements to employees and explained his company was on the verge of the bankruptcy. He also opened the breakdown of sales and the expense of the income statement on this occasion, then said to his employees that “I will not dismiss anybody. If you work twice as hard as before it would do much help to achieve my ambition<sup>ix</sup>”.

As a result of check their management resources, he concluded handmade high quality nail clippers could not be manufactured by other companies as they did not remain the skilled workers with increased mechanization. Therefore, there is a strong competitive advantage for high quality nail nippers, certainly its sales was expected to grow by increasing the production volume. In order to increase the production volume, it was important to increase the number of skilled workers who could be responsible for difficult processes. In fact, there were only two skilled staffs who could work in the process at his company in 1996. However, only increasing the number of skilled workers would increase in fixed costs and to nurture skilled workers took such a period of more than 10 years

As a result, the company made rookies be introduced in easy manufacturing processes and

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<sup>viii</sup> Yomiuri Newspaper (2014) Jan.4th,p11.

<sup>ix</sup> Shoko Research Institution (2011) p104, 118.



skilled workers can concentrate on most difficult process to lead mass-produced high-quality nail clippers production system in the high performance while reducing the cost. In next step they made a mechanism for education and training for semi-skilled workers or rookies to improve their skill quickly. For this purpose, they managed each process in detail and measured each process cost by using the management accounting. The data allowed them to set up the price in each process unit and operated them effectively and to have planned training system in order to nurtured skilled workers. As a result, transformation of business structure had done and core business had been changed step by step.

To summarize the concept of PPM implementation for SUWADA Inc., could be shown to the following two points.

- Sell their products at suggested retail price.
- The setting and operating each process from the viewpoint of cost management

How did they promote planned training for increasing productivity and nurture skilled workers? In the following section, it is mentioned in detail about manufacturing process and the way of setting each process unit price.

#### **4.3 Setting of a manufacturing process and the process unit price**

In SUWADA Inc., total production process is divided into about 50~80 processes. The main processes are shown as 10 following processes.

- 1) Heat with fire: The material heats with fire until reach about 1200 degree Celsius.
- 2) Forging: Swat it by power of 400 tons
- 3) Mold: Mold it into the form of a nail nipper
- 4) Part processing: Because there is individual difference in materials, the size of parts processed to be a same size.
- 5) Fabrication: Put right and left of the part get together
- 6) Grind: Polishing to make a shape of nail clippers with special sandpaper
- 7) Alignment: Adjusting overall movement of nail clippers by making the balance of right and left parts.
- 8) Alignment of cutting edge: Adjusting cutting age with special sandpaper
- 9) Put sharp blade on the edge: On the inner side of the cutting edge, the worker put a thinner sharp blade too

- 10) Final check: It is checked in terms of its quality and outlook

They are bottle neck processes of Number 8 and 9 and required considerable skills.

#### **4.4 Setting and measurement of process unit price and the process cost**

To set the process unit price, they needed to measure the value attached in each process and to analyze costs for each process using a method of management costing. Thus they classified more finely the above-mentioned 10 into 50 to 80 along with each items production process and ranked each step on the level of difficulty. Then, at first they calculated gross profit margin from the sales price as “an ideal total cost” and divided them into each process according to the rank of difficulty. They called then as process price.

Furthermore, they also measured process cost. As most process costs derived from the labor costs of the person in charge of the process, each process cost was calculated back from each person's salary.

To facilitate the comparison of two numbers that process unit price and the process cost visualized the value of the skills and cleared who contributed to earn money in the company. The company relocated their worker in each process in accordance with the degree of skill in order to minimize bottleneck and improve productivity.

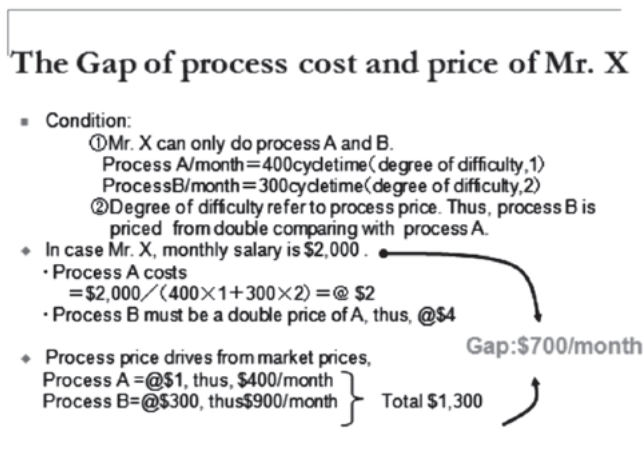
#### **4.5 Introduction of payment system based on skill and performance**

In order to do the nail clippers as the core business, they needed to improve the productivity of the craftsmen each individual as well as it is necessary to improve and/or adopting each skill. So they introduced a new payment system based on skill and performance in 1996.

The system had a feature that salary derived from the sum of the added value for products by employee in each process. Speaking more simply, it was intended to be visible if there was a difference in the process unit price and the process cost. It had put an intention that if there was a difference between the two, the worker had to notice and realized that he/she was required to catch up to its salary as soon as possible.

Figure 6 shows a conceptual diagram thereof. For example, Mr. S carried on only simple two steps among the total 50 steps for producing a product. Degree of difficulty of the process is a counting process unit price. Multiplied by the numbers that was carried out processes with the unit price is a produced value. In the case of S, it can be said that there is a gap between his salary and total produced value about \$ 700 per month. In order to fill in the difference, he should improve the productivity in order to make more than ever, and/or to learn the skills which required in difficult processes which has much unit price.

Figure 6 The Gap between Process Cost and Process Price



Value to the each process has been visualized by a process unit price. Therefore, in case the unit price is high, workers had a incentive trying to learn it even with difficulty. More than anything else, it also became the incentive to increase the cycle time in order to reduce their process costs by improving productivity. In addition some processes which were important but exercised not well such as cleaning up and cleaning of the tool processes started to be carried out properly because it became to be required to record at the end of any process.

#### 4.6 Introduction of personnel evaluation system to achieve both productivity improvement and skills inheritance

By visualization of added value due to the setting of the process unit price and payment system per productivity had improved productivity and led to the incentive of skill acquisition. However, thorough of pay-for-performance caused friction between the skilled workers and rookies.

In particular, the new evaluation system gave incentive to the skilled workers anyway promote their work more and more rather than taught carefully to the rookie. In addition, it also led a result of increasing stocks in process. In case the skilled workers carry out the improvement of productivity in individual, work-in-progress is increased. To pass on knowledge and skills from skilled workers to rookies does not proceed because the formers just concentrate on their work. This make workplace atmosphere deteriorated. As a result, it causes a drop of productivity.

Therefore, management and employees have each evaluation meeting ones a year and check their contribution points for productivity and skill education. Unskilled workers are also checked how they obtain new valuable skills. For the meeting, there are two kinds of files, one is from employees based on the self-evaluation table, the other is management check list which include

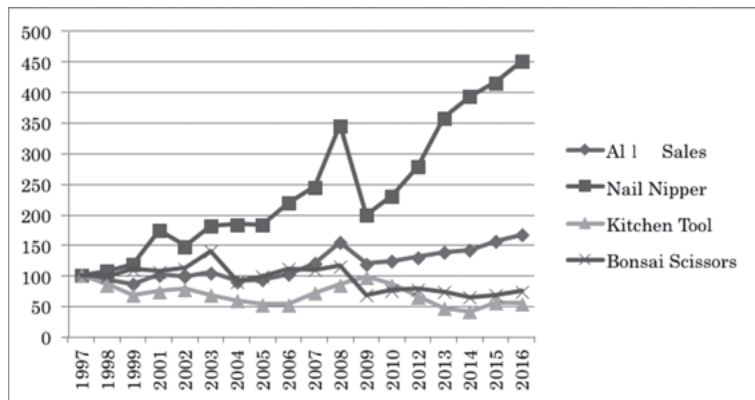
individual performance of productivity with actual number of cycle time on each process, the acquisition and/or teaching contribution of skills.

#### 4.7 Result of business change

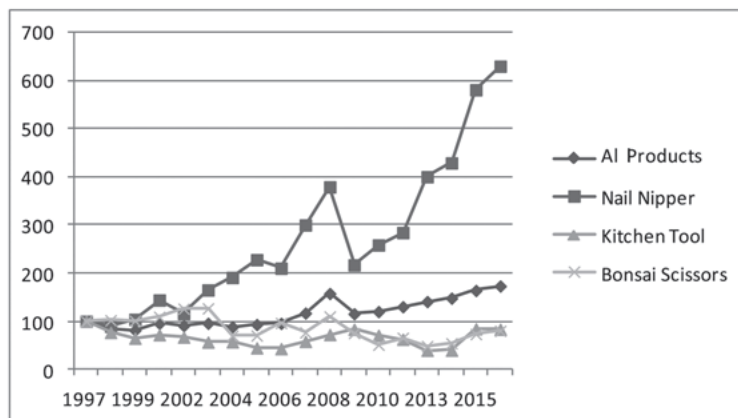
Result of a series of restructuring, the following five points was realized

- 1) Productivity was improved in order to skilled workers could be engaged to the bottle neck process.
- 2) It was placed rookie in a simple process in order to cost cut(labor costs per one fell), on the other hand the production volume increases.
- 3) Value of the skill and contribution of productivity improvement has been visualized. In other words, it was introduced a payment system based for performance which related to productivity and value of skills. It was given the incentive of improvement of productivity and skill acquisition from the skilled workers.
- 4) Against deterioration of work environment that comes from the harmful effects of 3), it was introduced the conduct performance review for skilled worker which evaluate his/her teaching skills for rookies. Then, worthy skills have been inherited easily by incorporating the education of the newcomer from skilled workers.
- 5) Because they know the process cost, it has become easier to estimate more accurate product cost. In addition, they have become possible to put a proper price for such custom-made goods.

Figure 7, it shows the transition of sales from 1997 to 2016, means that their core business has been dramatically changed to nail clippers. It is defined sales in 1997 as 100, then, in 2016, nail clippers have become 4.5 times comparing with the number in 1997. Because nail clippers used to be a low price with high quality, the company did not make much. Then, the company established a system to develop and make the clippers more quantity keeping in high quality in order to bring up them as a core business. In addition, they provide the product for the customers who recognized its quality and pay suggested retail price. Though kitchen tools and bonsai scissors were a care business in the 1990s, it has lowered sales. In particular, as sales of kitchen tools had been a top-selling in 1990, it become about half volume. It is clear that sales of nail clippers have contributed to increase the total volume of sales as it is now.

**Figure 7 Business Change from the viewpoint of Sales (1997=100)**

According to the following figure (See Figure 8), the transition of marginal profit also shows that their core business has been dramatically changed to nail clippers. It is defined marginal profit in 1997 as 100, then, in 2016, nail clippers have become 6.3 times comparing with the number in 1997. That is, their business mix mainly containing nail clipper from the viewpoint of profit.

**Figure 8 Marginal Income (1997=100)**

## 5. Managerial implications and conclusion

In this paper, we examined and analyze SUWADA Inc., who has become a manufacturer of the high quality and high profit of nail clippers without the mechanization of the manufacturing process, as a case of successful business transformation with management accounting. We also mentioned that how they have been brought up skilled workers with management accounting. Then, it become clear that small company of about 50 employees found to have carried out the ingenuity by using the data obtained from the costing. As a result, their productivity also improved and promoted the transformation of the core business structure. Implementation of management accounting that meets the corporate strategy was the push-up the performance of the company. In this year, their sales have approximately doubled in about 6 billion yen comparing with sales in 1996<sup>x</sup>.

They started to show their financial statements to employees approximately 20 years before when they were on the verge of the bankruptcy. Management required their employees to know they were in the crisis of bankrupt. They still share financial information even now that they enjoy good profit. Their bonus has been paid more than amount of 5months from 2005 and their salary level ranked a one-third high rank of SMEs average in Japan. Recently SUWADA built a shop near their open factory. The factory and shop are located so local area, but more than 20,000 people visits there and enjoy observing their manufacturing process and buying some goods at the shop<sup>xi</sup>.

As well as the management method of SMEs is said to be a great variety of, management accounting has the unique usage by each companies according their strategy and it comes out in the open only with an interview.

Investigation of management accounting into SMES has been just started. Therefore we will perform further investigation, and analyze them enthusiastic from now on. Finally, we appreciate Mr. and Ms. Kobayashi's cooperation for our interviews and provide internal information in order to clear our research challenge.

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<sup>x</sup> Even in August 2016, with the popularity the amount of production cannot keep up with the demand. There is a long queue from six months to two-year up to items. (2016/August/9 in interview) .

<sup>xi</sup> Mr. Kobayashi told that the shop contributes to cost reduction because discarded items such as too polished can sell the place. In addition, the sales of shops achieved more than 1% of total sales for the company.

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