

Management Control in Multinational Firms: Future Research Directions

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ABSTRACT

Issue of control in the multinational companies has been very much debated by the scholars in the area of international business. The changes in global competitive environment have led to changes in the headquarters-subsidiary relationship. Control has been typified less by chain of command, and more by mutual interdependence, and learning. Thus, the issue of control in multinational firms and the future research direction in this area are discussed in this paper. In so doing, the types and forms of prevailing multinational firms and the forms of control are elaborated. The processes of transfers of management practices especially that of management control practices are also discussed in terms the factors influencing the transfer process, the transfer mechanism, and the effects of transfer.

Keywords: management control, multinational firm, issue of control, international business, global competitive environment.

1. INTRODUCTION

Issue of control in the multinational companies (MNCs) has been very much debated by the scholars in the area of international business. The debate ranges from firm-specific advantages (Rosenzweig and Singh, 1991), host-country/MNC relations, and the control, configuration, and coordination mechanisms used in managing MNCs (i.e. headquarters-subsidiary coordination) (Jaussaud and Schaaper, 2006; Holtbrügge, 2005; Legewie, 2002; O'Donnell, 2000; Marschan, Welch, and Welch, 1996; Martinez and Jarillo, 1989; and Flamholtz, Das and Tsui, 1985).

MNCs control their foreign subsidiaries under complex ownership structures (Roche, 1996) and the kind of operations that foreign subsidiaries undertake may take different forms such as direct manufacturing, licensing of technology, research and development or other pieces of the value-added chain including a

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separate product division. Contrary to a single entity that faces a homogeneous environment, headquarters' control of the MNC is said to be more difficult because the MNC is composed of a set of differentiated structures and processes (Merchant and Van der Stede, 2003, p.593) each of which existing in one of the subsidiaries of the organization.

The changes in the global competitive conditions (deregulation, globalization, the emergence of powerful developing economies and technological diffusions) have witnessed "a shift away from a dyadic, hierarchical view of the MNC headquarters and its subsidiaries, toward a perspective in which the multinational organization is viewed as a web of diverse, differentiated inter- and intra-firm relationships" (O' Donnell, 2000, p.526). The headquarters-subsidiary relationship has been typified less by chain of command, and more by mutual interdependence, and learning. Intra-firm, inter-unit relationships are demonstrated as playing just as important a role as headquarters control in implementing strategies in a global organization (O' Donnell, 2000). This has resulted in massive transformation in global corporations to redefine their strategies, structures, and processes (Busco, Frigo, Giovannoni, Riccaboni, and Scapens, 2006). The implementation of global strategies will give headquarters a crucial role in controlling subsidiary behavior (Andersson and Forsgren, 1996). As opposed to multi-domestic firms, which can be visited often and monitored closely by the headquarters, for global firms, which have subsidiaries that operate in more than one country (Merchant and Van der Stede, 2003), making visits and monitoring would not be as easy and as frequent as the headquarters management would want it to be.

The MNC is regarded as a powerful mode for the transfer of not only capital and other production functions but also managerial and technical knowledge across nations (Tayeb, 1998). However, Liu (2004) highlighted that when selecting their practices, subsidiaries of an MNC are usually faced with two options: adopting locally designed practices or acceptance of practices originating with the parent company. Taylor, Beechler, and Napier (1996) identify three generic strategic international human resource management (SIHRM) orientations: adaptive, exportive, and integrative. MNCs that create systems for subsidiaries that reflect the local environments have the adaptive orientation. Firms that seek to transfer practices that are seen as successful in the parent company to its subsidiaries adopt an exportive orientation. Finally, MNCs with an integrative orientation attempt to transfer the best practices throughout the organization. Nevertheless, the transfer of management practices from the parent-company to the overseas subsidiary is not done wholly, due to the various complexities faced.

Thus, the purpose of this paper is to discuss the insights from the literature on issues on how MNCs achieved control of their subsidiaries especially those subsidiaries located in foreign countries and to suggest the directions of future research in this area. In so doing, the process of transferring management

practices are also discussed. The paper proceeds as follows. Control in MNCs is discussed in the next section. It concentrates on the types and forms of prevailing MNCs and the forms of control. The second section is to elaborate on the conceptualization of management control system. The third section elaborates on the process of transfers of management practices especially that of management control practices (MCPs). It discusses the factors influencing the transfer process, the transfer mechanism, and the effects of transfer. The final section discussed the directions of future research in this area

2. CONTROL IN MNCS

Mouritsen (1995) has looked at various organizational structures of the MNCs and one of them is the global company. In a global firm configuration, the headquarters play a coordinating role, ensuring that the local-firm advantages of each business unit are completely exploited for the achievement of the overall corporate goals. It is argued that input from overseas local subsidiaries is often discouraged when product managers at headquarters make product decisions for the global market (Mouritsen, 1995). The global firm is portrayed by its large geographical reach, its organizational interdependence and its ability to incorporate reasonably activities performed in different countries. The distinct segments establish a succession and they are strongly connected. Foreign subsidiaries in global industries exhibit a higher degree of interdependence with other subsidiaries within the MNC, to provide managerial know-how, technology, capital, and key personnel. These subsidiaries also may depend on intra-corporate sales if they transfer output elsewhere in the organization instead of selling a finished product on the local market. As such, the firm's competitive position in one country is affected by competition in other countries (Porter, 1986). Consequently, these subsidiaries are less dependent on the local surroundings, are under less hassle to correspond to institutional norms, and are less sensitive to selection pressures faced by firms in the same country. Thus, their organizational structure and managerial practices may resemble more fully those found elsewhere in the MNC.

Gupta and Govindarajan (1991) allege that an MNC following an international strategy does not pursue complete global consistency or local responsiveness, but attends to both, by transferring knowledge and expertise across borders (Bartlett and Ghoshal, 1989, cited in Liu, 2004). The structure of an MNC pursuing an international strategy is coordinated, where subsidiaries have the freedom to adapt products to local conditions, whilst at the same time being dependent on the parent company in terms of new products and ideas. The global strategy is characterized by the pursuit of global efficiency and consistency. The structure of an MNC with a global strategy is centralized and subsidiaries are highly resource dependent on the parent company (Bartlett and Ghoshal, 1989, cited in Liu, 2004). Based on the above, Liu (2004) argued that the global MNCs, is most

likely to promote the transfer of management practices from the parent company to its overseas subsidiaries. Under the global firm structure, local subsidiary managers are usually involved only in the local administrative and management, legal, and financial affairs of the company. Local autonomy is said to be very limited, and the local subsidiaries are treated as cost centres as opposed to profit centres (Paik and Sohn, 2004).

However, to meet such a growing challenge from both global integration (globalization) and local responsiveness (localization), the transnational organization structure (Bartlett and Ghoshal, 1998), which seems to share the important characteristics of the matrix organization structure, in which local subsidiaries report to both area (regional) and product managers (Bartlett and Ghoshal, 1992), is suggested. As such, MNCs are viewed as networks of horizontal decision-making, where local subsidiaries and headquarters are to be positioned at the horizontal, rather than hierarchical level. However, the matrix structure of a transnational organization could pose potential problems especially when both product divisions and area divisions have inconsistencies. Thus, transnational organizational structure is said to be ideal but difficult to materialize (Paik and Sohn, 2004). Alternatively, MNCs may adopt a two-tiered regional headquarters (RHQs) arrangement (Paik and Sohn, 2004), which signifies an organizational structure aimed to sweep away the possible strain between the pull for global efficiency by the headquarters and the push for national effectiveness by the local subsidiaries. Under this structure, an RHQ is established in each of the major geographical areas (Paik and Sohn, 2004).

Irrespective of types of MNC organizations, control issues is of utmost importance. As Pucik and Katz (1986, p.121) state it, "MNCs must monitor and coordinate their global research, production and marketing capabilities, much more now in order to gain a global competitive advantage. This requires not only the identification of optimal investment patterns, but also the movement of resources, including technology, capital, and personnel, across national boundaries. With this expansion of global resource transfer, the issue of effective control in a multinational firm has grown as well".

In order to achieve and maintain control of their operations, MNCs face several complexities not encountered by domestic firms (Rosenzweig and Singh, 1991). Sometimes, attempts to implement standardization of practices across all international operating units may not necessarily consider the special needs of an individual subsidiary or the specific roles it plays for the benefit of the whole organization in a global context. Thus, MCS must be designed to meet the need for information generated by the strategy or objective of the MNC (Nilsson and Rapp, 1999).

Given the challenges of establishing and maintaining control in international operations, it is not surprising that mechanisms of control and coordination have become important topics in the study of MNCs. Among the means of

coordination and control that have been studied are human resource management (Edstrom and Galbraith, 1977), corporate culture (Jaeger, 1983), and “fit” governance structures (Ghoshal and Nohria, 1989). Each mechanism is designed to regulate activities of the foreign subsidiary in order to meet organizational objectives (Rosenzweig and Singh, 1991). Martinez and Jarillo (1989) provide an extensive review of this research.

3. CONCEPTUALISATION OF MCS

Control is related to organizational purposes, coordination and change. It relates to how the behaviour of managers and employees can be influenced in ways that could lead to the accomplishment of the organizational goals (Merchant, 1997). Control systems have been conceptualized and categorized in various ways (Langfield-Smith and Smith, 2003): formal versus informal controls (Edstrom and Galbraith, 1977), behaviour versus outcome controls (Ouchi, 1979; Eisenhardt, 1985), mechanistic versus organic controls, bureaucratic versus clan controls (Child, 1973; Balliga and Jaeger, 1984). However, they argue that those characterisations are not dissimilar and there is some agreement that all organizational control systems consists of formal, explicitly designed controls, as well as the unwritten informal or social controls that cannot be designed directly.

Social controls are present in all organizations to varying degrees (Ouchi, 1979). It may develop from shared norms, values and beliefs, and may rely on the internalization of goals, which leads to organizationally desired behaviours. These controls cannot be designed explicitly, but can be shaped and influenced by activities (Ouchi, 1979). Cultural control is more implicit and informal rather than explicit and formal (Balliga and Jaeger, 1984). Under such control, all the organizational members share a common culture which is defined as a specific pattern of expectations and beliefs.

In an operational sense, Merchant (1997) defines control as including the steps taken by the managers to ensure that the implementation of organizational strategies. An MCS is therefore concerned with “planning, the actions taken to implement plans, the monitoring of both these actions and the plans and any necessary modifications to the plans” (Merchant, 1997). MCS are used by managers to assist them in performing all of the control functions within complex organizations such as an MNC. Overall, management control is a broad concept, and its definitions encompass far more than accounting and budgeting systems (Kloot, 1997). Merchant (1997) conceptualizes MCS as consisting of various categories of controls such as action controls, results controls, personnel and cultural controls and highlights five methods of shaping culture and effecting cultural controls: “codes of conduct, group-based rewards, intra-organisational transfers, physical and social arrangements and tone at the top” (Merchant, 1997, p.124).

In this study, the researcher will take Merchant's (1997) broader view of MCS, which focus on "encouraging, enabling, or sometimes, forcing employees to act in the organization's best interest" (p.2). Merchant's model of MCS is used because "it embraces a wide range of formal and social controls, is operationally well defined, has informed or is consistent with MCS models in previous research, and is not confined to large organizations" (Davila, 2005, in Efferin and Hopper, 2007). Also, it recognizes that some controls are proactive, rather than reactive. Proactive control means the "controls that are designed to prevent control problems before the company starts to suffer from any adverse effects on performance" (Merchant, 1997, p.2). Examples of what Merchant considers as proactive controls include planning processes, required expenditure approvals, computer passwords, and segregation of employees' duties.

4. TRANSFER OF MANAGEMENT PRACTICES IN MNCS

From empirical research undertaken (Rosenzweig and Singh, 1991), the subsidiary structure and process are influenced by a number of factors. The factors are the host country's legal regulations, shared technology, parent country culture, cultural distance, composition of the workforce, acquired versus greenfield subsidiaries and dependence of the host country on the MNC (Namazie, 2003; Ferner et al., 2001; Kostova, 1999; Wells, 1998; Beechler and Yang, 1994). Additionally, whether the foreign subsidiary operates in a multi-domestic or a global industry also determines the structure (Porter, 1986), the compatibility of the organizational cultures of two organizations involved in the transfer (Kedia and Bhagat, 1988) and the values underlying the practice (Kostova, 1999).

Such institutionalism studies indicate that the influx of foreign capital has not led to a radical shift in management practices and organizational structures. Nevertheless, Royle (1998) provides evidence that, even within the most highly regulated host countries, MNCs are able to exert a distinctive country-of-origin influence on local HR/IR policy. The ability to transfer a practice is influenced not only by factors at national and company levels but also by the knowledge and innovation characteristics of the management practice transferred. It is argued that the transfer of management practice is necessarily associated with technology or related product process transfers (Beechler and Yang, 1994). However, the empirical researches conducted are very much survey-based that would not be able to provide explanation of the transfer process as well as the process of implementation and/or adaptation of a new management practice in an organization.

The process by which a parent company practices are transferred from the headquarters to the overseas subsidiaries of an MNC is a complex one that

depends on a number of internal and external contingencies (Wells, 1998). According to Liu (2004), the theoretical approaches to analyse transferability at company level exist in two main categories: organizational culture and resource dependence. Based on the organizational culture theory, the compatibility of organizational cultures is recognized as an important factor to influence the transfer of management practices (Kostova, 1999; Taylor et al., 1996). Applying the resource dependence approach to MNCs, researchers have argued that because subsidiaries rely on their parent company for resources, they are dependent to varying degrees on the parent company. Ghoshal and Nohria (1989) argue that the greater the dependence of the parent company on the resources controlled by its subsidiaries, the more likely the parent company will attempt to exercise control over these subsidiaries.

Owing to the complexity of the transfer process, the transfer mechanisms whereby management practices are transferred to different international sites within MNCs have not been studied completely apparent (Liu, 2004). Nevertheless, a significant body of international management scholars has contributed much to the relative literature, either from theoretical or from empirical research (O'Donnell, 2000). A variety of mechanisms that are used to facilitate the transfer such as the transfer through rules, programmes, procedures as well as expatriates.

Liu (2004) argued that transfer mechanisms can be classified into two types in terms of the implementation process of transfer i.e. direct and indirect transfer mechanisms. Both mechanisms are complementary rather than substitutable. Direct transfer mechanisms mean that subsidiaries are asked to comply with a set of management policies from the parent company through which the MNCs achieve their control over subsidiaries. Indirect transfer mechanisms, on the other hand, implement the transfer of management practices to the subsidiaries through attaching the management practice to some carriers. The carriers here include organizational culture and expatriates from the parent company. Management practices transferred to subsidiaries are generally expected to be institutionalized so as to impact subsidiaries' performance positively (Liu, 2004). As the number of subsidiaries adopting the same practice increases, such a practice is institutionalized in the whole MNC (Guler et al., 2002) and it will form its special competitive capacity.

Kostova (1999) distinguishes the implementation and internalization as two distinct levels of institutionalization. Kostova (1999) stresses that implementation is an essential condition for internalization and that the former does not automatically bring about the latter. Internalisation is, according to Kostova (1999), "the state when a practice becomes infused with value, that is, when the employees consider the practice to be part of their organizational identity". Much of the literature on management control suggests the importance of management control practices in achieving coordination and control. Such practices are only

likely to be effective to the extent that they are infused with value for managers and employees. Therefore, only when the practice is implemented formally and is also internalized by the employees of subsidiaries will it become an institutionalised organization practice with strategic importance (Kostova, 1999).

The home country of the MNCs is a contributing factor to forms of control used. A good example is the German MNCs. Germany's business system is highly distinctive, differing in many aspects from the United States or the United Kingdom such as using a long-termist approach, placing importance of family ownership among German MNCs of all sizes, and the relative tardiness of German companies in establishing production and large-scale employment outside Germany (Ferner et al., 2001). Also, it was found that German firms were more likely than Japanese firms to adapt to local practices in benefit policy (Rosenzweig and Nohria, 1994). Whereas Harzing (1999, as cited by Ferner, et al., 2001) has found a distinctive German pattern in the control of international subsidiaries, particularly in the way expatriate managers are used to exert direct control of subsidiaries.

Furthermore, German companies are known for having a highly developed system of vocational education and training shaping a technically competent and flexible workforce appropriate to a focus on technologically sophisticated, quality products. German companies also give prominence on consensus and cooperative decision-making within firms, reflecting the statutory framework of industrial relations and the German philosophy of the 'works community' siding with the whole workforce. In terms of corporate control, the Germans have a distinctive pattern of corporate control in which bureaucratic mechanisms sit alongside personal or informal controls within companies, with a strongly functional division of labor based on different sorts of specialist expertise but with few rigid differentiations at workplace level.

As mentioned by several authors including Merchant and Van der Stede (2003), the appropriateness of the management control system design choice does depend on several situational factors such as environmental uncertainty, organizational strategy and multi-nationality. Jones (1985) is of the opinion that even if a management accounting system (MAS) was ideally suited to the structure of an organization and its environment; the implementation may fail because the process of change is improperly carried out. The view that order and discipline could be instilled in the acquired company by the somewhat mechanical extension of the parent controls is debatable. Thus, implementation and adaptation of a parent-company MCS on to the local subsidiary is not an easy matter.

5. DIRECTIONS FOR THE FUTURE

Much of the research carried out on MNCs is related to the effects on human resource management (HRM) practices rather than the overall management control practices (MCPs). However, given the consumers' continuous demand for locally differentiated products reflects significant variance in standards, tastes, as well as perceived needs; the internal managerial practices of the MNCs must also be adapted in order to fit local culture and authorized expectations of the host country (Paik and Sohn, 2004). Yet, efforts to implement standardized policies and managerial practices across all international operating units may completely ignore the special needs of an individual subsidiary or the specific roles it plays for the benefit of the whole organization in a global context. This may result in a decrease of the overall performance of the organization (Doz and Prahalad, 1984).

Thus, how do we adopt management control practices (MCPs) across borders, given that there are a lot of issues involved? Research on the topic is still in its early stages (Merchant and Van der Stede, 2003). Thus, the nightmare to MNCs is to institute a system that will effectively fiddle with the two conflicting needs of globalization and localization (Paik and Sohn, 2004). It involves creating a system that will simultaneously be centralized enough for global integration and decentralized enough for local responsiveness (Bartlett and Ghoshal, 1998).

Given the difficulties and the complexities of controlling an overseas subsidiary from a distance, and that not many studies have embarked into contributing research in this area, research in this area greatly needed especially to help design an effective management control system for the MNCs. Moreover, how a superior can influence events over a distance is again questionable since the potential for misinformation or misinterpretation could arise, could render the decision made on the basis of such information to be inappropriate (Roberts and Scapens, 1985). Could standardised report be a solution to such a problem? Accordingly, this leads to the other important issue related to control in MNCs which is the decisions of standardization and/or localization of key management practices of foreign operations (Berry *et al.*, 1985). Again, the question arises, especially if the MNC is a diversified conglomerate, would the standardize report be appropriate for all of its kind of businesses? Drawing on this development in managing MNC, and the changes in hierarchical control that it leads to, how is control achieved in a contemporary MNC? From the review of literature carried out, enhanced understanding of how control is achieved by a MNC on its foreign subsidiaries is needed. Not many studies have conducted a research on the transfer, or implementation, or on the adaptation of a foreign MNC's on local subsidiary.

There is still a lack of such an in-depth research that examines the process of transfer of MCPs. Furthermore, even though many researches to date have exposed the extent of accounting change at an organizational and/or (inter)national level (Burns, 2000), only minimal attention has been devoted specifically to understanding and explaining why and how accounting evolves in the manner it does, through time, and within specific organizational settings (Burns, 2000). In addition, many of the studies previously conducted were looking at control from the perspective of the parent company, and not much research has been examining the impact of transferring of management control practices on the receiving subsidiaries. A number of survey-researches have been conducted to examine the management or control of foreign-owned subsidiaries by the headquarters (see for example O'Donnell, 2000; Myloni, Harzing and Mirza, 2004; Richards, 2000; Al Chen, Romocki and Zuckerman, 1997; Nohria and Ghoshal, 1994). However, the studies are largely exploratory in nature and the results are generally descriptive. Only a limited number of in-depth case study researches on transfers of MCPs have been conducted. One such study would be that of Busco et al. (2006)

Questions such as “in what circumstances, by what processes and with what effects are management practices and routines transferred from an MNC parent company to subsidiary?” In line with that question, the researcher identifies a series of research questions: What factors influence the transfer of management control practices (MCPs) in MNCs? How are MCS transferred and subsequently internalized in their foreign subsidiaries? How can we understand the transfer process? While some questions have been partly explored by different researchers, a comprehensive research framework has not yet been formed (Liu, 2004).

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