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Control of International Operations

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No organization can accomplish its goals without proper control. The imperative of organizational control is heightened when firms cross national borders and expand into unfamiliar foreign markets. This chapter is all about how international operations and foreign subsidiaries are controlled. We first look at various control mechanisms and discuss, in detail, three approaches to control. The cultural aspects of multinational company (MNC) control, which is effective in dealing with the uncertainty and complexity of the international market, are elaborated. Finally, within the context of the historical evolution of the international environment, the corresponding MNC coordination and control mechanisms are summarized. There are differences between the control of an MNC and that of a domestic firm. These differences are due to the complexity of and uncertainties surrounding the MNC environment, with a resulting potential for difficulty. The relationship with the host government creates additional problems. Following a discussion of control problems of MNCs, the influence of host government actions on MNC control is analyzed.

Chapter Vignette

During the 1980s, many developing countries experienced financial crises. Most of them were forced to block the transfer of hard currencies abroad. Multinational companies (MNCs) operating in these nations were unable to repatriate earnings or assets. In effect, the MNCs' control of these funds, and indirectly a partial control of their businesses, was subject to host government policies. Some firms used unique methods to move the blocked funds abroad. Columbia Pictures, for example, filmed a movie in Kenya to use up blocked funds generated by its parent company, Coca-Cola. In Tanzania, another firm found a creative way to spend money blocked in the country. For a while, it booked all its airline tickets for all destinations in or out of Tanzania at Dar es Salaam, the capital of Tanzania.¹

The blocking of funds is only one way host governments interfere with the normal business operations of MNCs. Often, MNCs lose some control over their foreign subsidiaries due to host government demands. A common practice is to renegotiate contracts, often because the original agreement is so much in favor of the MNC that a renegotiation is expected. A famous example is the case of General Motors (GM), a wholly owned subsidiary in Australia in the mid-1950s. In 1954 and 1955, the GM subsidiary's profit after taxes amounted to 560% of the original investment, and the dividend paid to GM represented 8% of the Australian balance of payments.²

One-sided contracts are not always the reason MNCs lose control over foreign subsidiaries, nor does this necessarily happen because of renegotiations. Cases of outright takeover of foreign subsidiaries for

political reasons have occurred. Whenever, and for whatever reasons, host governments initiate a renegotiation process, MNCs are usually reluctant participants. Consider the Papua, New Guinea, government and the three mining companies that own most of the big Porgera gold mine in that country.

The Government of Papua, New Guinea, shared ownership of the Porgera mine with subsidiaries of Placer Dome of Vancouver, Canada; Hanson PLC of Britain; and M.I.M. Holdings Ltd. of Australia. The three companies each owned 30%, and the government owned 10% of the mine, until the government decided to increase its share to 25%. This reduced each firm's stake in the mine to 25%. To finance the purchase of the additional 15% of shares, the Government of Papua proposed that the \$136 million needed for the purchase would be generated by the cash flow from the same amount from the newly acquired shares. In effect, according to a financial analyst, Papua, New Guinea, was paying the firms with their own money, at a price 20% below market value. When the government declared its intention to raise its stake, however, it suggested that production and profit from the mine had exceeded initial expectations. It claimed that the companies had withheld information and understated the mine's potential in their first negotiation.³

Introduction

The effective management of an organization, among other factors, depends on securing continuous and sufficient progress toward goals. Management must determine if the organization is following the right strategies and if these strategies are being implemented correctly. Sound management also involves asking whether the organization is moving in the proper direction and if the results obtained are those intended. Organizational control could provide answers to these questions. Control is needed not only for detecting problems and deviations from plans but also for anticipating problems before they occur. Simply put, control and strategic planning functions are very closely related and interdependent. A good plan has a built-in control system that monitors the implementation of the plan and provides information on goal attainment. It often involves highlighting problem areas and identifying the difficulties in carrying out the plan. Information supplied by various control mechanisms also assesses the validity and appropriateness of a strategy.

In the following pages, we introduce the major elements of the traditional control system. Using this introduction as a background, control tactics for MNCs are then discussed.

Purpose and Functions of the Control Process

Organizational control refers to the process of monitoring and evaluating the effectiveness and efficiency of organizational performance and taking corrective action when performance falls short of expectations. Based on this definition, the process of implementing control system involves four steps.

First, spell out the intended results and establish the standards against which organizational activities and accomplishments can be measured. Second, monitor and collect information on organizational activities that are aimed at goal accomplishment. Third, evaluate organizational performance and results for effectiveness. Fourth, make necessary adjustments to correct deficiencies during and after the implementation of the strategy.

Deficiencies could be due to shortcomings in implementation or flaws in the strategy. The failure of a strategy could also be related to changes in the environmental factors that were the basic premises of the strategic plan. In any case, a properly constructed control mechanism should provide information regarding the shortcomings. Therefore, control could be viewed as the last step in the strategic management process, coming after planning and implementation but with potential to feed information back into those systems as it is acquired.

Problems may arise at any point along the four stages of the control system. Inadequate information, for example, could result in inaccurate standards being established. In turn, the use of deficient standards in measuring progress toward goals could falsely indicate performance failure on the part of organizational members.

Based on the differences in time horizons and scope of coverage, planning may be either strategic or operational. Strategic planning involves the total organization, deals with its long-term survival, and requires nonroutine solutions. Routine solutions deal with recurring issues. Nonroutine solutions involve problems that are unique, and past experience is not very useful for their resolution.

Operational planning takes into account shorter-term performance requirements and deals with recurring problems that are often the domain of individual organizational units. The two types of planning have their corresponding controls, strategic and operational.

Control Mechanisms

Several control mechanisms can be used individually or in combination in an organization. Some are very formal, such as various reports from lower levels of the organizational hierarchy to higher levels. Others are informal, such as socialization and acculturation, which instill organizational values in members and create uniformity in decisions and actions. In the following section, we will review the major control mechanisms.

Input and Output Controls

Organizational activities and performance may be regarded either as inputs or as outputs. In using various control mechanisms, a firm has the

choice of controlling the inputs, the outputs, or a combination of both. Input control is regarded as behavioral control, where expectations are communicated to employees in advance. Then, through personal supervision and surveillance, they are guided and directed to reach goals. Of course, rewards and punishment are the instruments that are used to induce goal-oriented behavior modification. Input control relies on feed-forward information. It works best in small organizations and where the low level of complexity allows managers to identify the desired behavior in advance. Also, input controls could be more useful at the lower levels of the organization, where activities and their outcomes are more predictable.

Output control is result oriented and uses impersonal measures such as the difference between the expected and the final outcome. It relies on feedback information to correct deviations. Output control works well for large organizations, where the complexity and heterogeneity of activities require standard objective measures of comparison. Organizations tend to use more output controls at the higher levels of the hierarchy, where there is a high level of complexity and interdependence among tasks. Output control systems are reactive, whereas input controls are proactive. Of course, the two control systems are complementary.

Locus of Decision Making

Usually, all major strategic and critical decisions are made by top-level executives. Some organizations may allow dispersion of decision-making power for other important matters among lower-level managers. *Centralization* of decision making is characteristic of a firm in which most decisions are made by top-level managers. In a centralized MNC, foreign subsidiaries have limited decision-making authority, and most important matters are decided by headquarters. The opposite is *decentralization*, where decision-making power is dispersed among more managers. Decentralized MNCs give more autonomy to their foreign subsidiaries. Centralized firms exert much tighter control over various parts of the organization than do decentralized firms.

Many factors determine the degree of autonomy granted to the subsidiary. Major factors include the nature of the decisions that need to be made and their impact on the rest of the MNC, the type of technology used, and the product and industry characteristics. In situations where the decision outcomes affect only the subsidiary and the host country market, managers are often given more autonomy. In large, globally integrated firms, decision making is more centralized so that the activities of various subsidiaries can be closely coordinated. Also, for the most important matters, such as negotiating new agreements with host governments, subsidiaries are required to clear their decisions with headquarters.

Technology and market characteristics may dictate the need for closer coordination among various subsidiaries. When products are mature, price

competition is the norm in industry. Also, when product components are manufactured by a number of subsidiaries, they become very dependent on each other. Price competition and interdependency require uniformity of activities and coordination among subsidiaries. Consequently, in a mature market and when there is a higher degree of interdependencies, headquarters is more apt to exercise central control.

Decision-making autonomy also varies within the functional areas. In a study of 116 MNCs and subsidiaries in the United States, United Kingdom, Germany, Japan, and Sweden, Hedlund found that subsidiaries had the highest autonomy in matters of personnel decisions and lowest for finance decisions. For production and marketing decisions, subsidiary autonomy was in the middle.⁴ A study by the Conference Board for 109 U.S., Canadian, and European MNCs reported similar findings. They found that these firms exercised stricter financial control and allowed greater local freedom for labor, political, and business decisions. Also, the home offices of these MNCs made the decisions to introduce new products and to establish R&D facilities.

Communication and Information Flow

Information collection on organizational performance is the linchpin in any control system. To assess the firm's viability and the relevance of its strategy, a variety of data must be collected from inside and outside the firm. To monitor performance, a variety of information is communicated among different parts of the organization. Strategies, goals, and expectations are communicated from headquarters to subsidiaries. Data on implementation of strategies, fulfillment of goals, and market information are sent by subsidiaries to headquarters.

Communication and information flow ranges from periodic financial and operations reports to occasional face-to-face meetings. Telecommunications technology has expanded MNCs' information-processing capability and has resulted in movements toward both centralization and decentralization. Through telephone, facsimile, electronic mail, and the Internet, headquarters is able to receive timely information from dispersed foreign operations and even remotely control equipment and machinery. Timely information allows more centralization of the decision-making process. However, decentralization efforts have also been aided by the speed and accuracy of surveillance and better control. Headquarters realize that they are well-informed and can potentially take more control, if need be. As a result, they are more amenable to granting decision-making authority to subsidiary managers. On the other hand, when circumstances call for centralization, headquarters will have more confidence in making decisions that are going to be applied in faraway operations.

Formal Reports. Formal reporting on financial and operational aspects along with local market data are essential means of subsidiary control by the

MNC. Most MNCs rely heavily on financial reports for control of foreign subsidiaries. Financial data such as return on investment and inventory turnover allow comparison with industry norms and provide information on the progress made in strategy implementation. Intrafirm business transactions and corporate tax variations among host countries make the use of financial data by MNCs more complex. This aspect of MNCs' control is the subject of conflict between host countries and the MNCs. Often, host countries claim that MNCs abuse intrafirm transactions and, through financial manipulation called transfer pricing, reduce taxable earnings and, consequently, corporate taxes.

The use of financial data for control of foreign operations has several limitations. For example, currency exchange rate fluctuations distort financial data, and strategic decisions by headquarters may limit the subsidiary manager's choice of the best possible business options. MNCs are aware of these limitations and temper the use of financial data with personal judgment.

Informal Communication. Informal communication is used along with formal communication to convey to members of the organization what the performance expectations are and to cajole them to comply with the norms. Informal communication is more subtle and indirect in enforcing organizational standards. Some firms, for example, communicate dress codes to members without making formal statements about them. Note, however, that physical distance and limited opportunities for regular face-to-face contacts with subsidiary managers compel MNCs to place greater reliance on the formal system of control.

Developing Global Control

One of the key points of international expansion is to organize and coordinate local operations with their headquarters; otherwise, confusions and misunderstandings might cause internal problems, and the possibility of growth would be diminished. Two American companies, Lincoln Electric, manufacturer of welding machines, and Gross Graphic Systems, a printing press manufacturer, faced these problems. Both companies changed recently: Lincoln changed from private ownership to being traded on the NASDAQ exchange, and Gross belonged to an important industry group and now is owned by a fund manager in New York. They came up with different approaches to solve their coordination and control problems: Lincoln began a process to customize its markets, and Gross decided to standardize development processes through a "product council."

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For Lincoln, operations around the world used to depend on the U.S. market. The first step was to level people from all over the world to the U.S. hierarchy. Then, local branches began to develop products for each specific market, considering regional differences and final usages. Another approach was transferring personnel to different locations to change American processes. Lincoln made an agreement with a Japanese control systems and robot firm to include its hardware in Lincoln's automated welding machines.

On the other hand, Gross engaged in a different process because local entities developed differentiated products but were unable to take advantage of their capacity for growth and development. The company established an international "product council" that meets monthly to discuss technical and marketing strategies that would be applied by the company worldwide. New products are developed using a global platform that can be modified to fit specific local and customer needs. The platform allows differentiation between markets and customers.⁵

Organizational Structure

In Chapter 8, we discussed MNC organizational structure within the framework of the organizing function. As a tool in implementing strategy, and as a skeletal framework that regulates and channels activities in prescribed directions, organization structure is an effective control mechanism. It is within this structure that formal communication channels and superior-subordinate relationships are established.

Increased competition and changing market conditions require a timely, concerted, and uniform response from various organizational units. To increase the organizational capabilities for a proper response to competition and other market forces, firms may need to institute more central control. For example, MNCs that find themselves faced with intense competition may require tighter control and could centralize their operations by restructuring. In response to increased competition in the United States, for example, Sony consolidated its electronics and entertainment operations under one corporate umbrella headed by an American executive. When Sony bought its entertainment companies, it was hoping to capitalize on the synergies between the electronics and the entertainment businesses. The expected synergies did not fully materialize because of the strained relationship between the two divisions. The electronics executives were often critical of the huge amounts that Sony spent on its Hollywood operations. Also, there was a cultural gap between the more prosaic hardware operations and the

glamorous entertainment division. With the restructuring, Sony intended to bring the two sides closer together and eliminate each division's preoccupation with its own priorities.⁶

Integrative Mechanisms

Various integrative mechanisms are used to control and manage interdependencies among different organizational units. The more common integrative mechanisms are liaison positions, cross-unit committees, integrators, and the matrix structure.^{7,8} These mechanisms form a continuum from simple to complex, moving from liaison to matrix in terms of complexity. Obviously, effective control is gained by matching the level of interdependency among organizational units with the complexity of the integrative mechanisms. A low level of interdependency calls for the use of a simple integrative mechanism, such as a liaison role. A more complex integrative mechanism, such as a matrix, is appropriate for the management and control of a high level of interdependency. Therefore, it is of no surprise that some global firms with a high degree of interdependency among their worldwide operations, such as Asea-Brown Boveri, have used a matrix form.

A liaison role could be used to improve coordination among interdependent divisions and to facilitate communication between them. If the two units have to refer to a higher level in the corporate hierarchy for solving their differences and working out their interdependence, a liaison can bypass these long communication lines. Liaison roles are used more at the lower and middle levels of organizations and, therefore, are more appropriate for operational control.

To solve problems of control and interdependence, integrative roles or departments are created whose responsibility is to enable the two units to work together smoothly. Typical titles and positions are product managers, program managers, and project managers. A product manager, for example, may integrate the marketing and production activities of a product between two separate divisions. Committees are frequently used at various levels of an organization for control problems that other mechanisms cannot handle, and they can be used on either an ad hoc or a permanent basis. Many firms have permanent executive committees that handle corporate-wide strategic problems of control and integration.

Resource Allocation

The primary relationships among various units of a business organization center on economics. One way of exerting control is through resource allocation. The pattern of distribution of resources (anything that people value, e.g., money, material, promotion, knowledge, technology, vacation, a large office, etc.) indicates to the members the performances and outcomes desired

by the organization. By changing the allocation of resources among subsidiaries, MNCs effectively exercise control over them. In some MNCs, the direction of resource flow is from the headquarters to the subsidiaries; in integrated MNCs, however, the flow of resources is multidirectional. A subsidiary's influence and its autonomy within the MNC is a function of the amount of resources it provides to the rest of the MNC. Ultimately, however, the headquarters determines the pattern of resource allocation and control, and it generally uses the budgeting system as the associated control system. We will elaborate on resource allocation as a control mechanism in a subsequent section on intrafirm business transactions.

Paper Tissue Control

Years ago, Jamont, a James River Corporation partnership with Italian and Finnish corporations, acquired 13 companies in 10 European countries. Through the process of integration across national borders, it learned a lot about selling toilet tissue to people of different cultures. The assumption always has been that German-speaking consumers bought strength, the French wanted soft, and Americans craved very soft. It turned out that consumers everywhere wanted both softness and strength. All these years, the manufacturers were dictating tastes instead of the consumers.

Product standardization proved to be a difficult task as well. Paper tissues were produced in different sizes in various countries, and there were other problems as well. The French, for example, were using 20 outside suppliers. That was reduced to 2. Each company used to make its own deep-colored paper tissues, a very time-consuming process. This was assigned to one plant.

Creating uniformity in measuring efficiency proved to be challenging. Some companies were counting a year with 330 days, allowing for holidays and maintenance time; others counted it with 350 days. This made the comparison between the operations of different plants a difficult task. A 95% uptime of one was not necessarily better than an 89% uptime of another.

Through consolidation, cost cutting, and instituting of control measures, revenues increased significantly and net profit doubled. These efforts made Jamont one of the largest paper producers in Europe.⁹

Budgeting System. Budgeting is the allocation of resources among various organizational units on the basis of present needs, past performance, and the projection of future needs. Budgets are standards against which actual performance can be measured. Firms use different budgets, such as

a capital expenditure budget, a marketing and promotion budget, and a research and development (R&D) budget, for monitoring important activities and functions.

With a budgeting system, MNCs not only monitor subsidiaries' activities but also establish priorities that reflect corporate strategies. Increasing or decreasing the budget is an effective way to dictate the direction of a subsidiary's development and progress. Earlier in this chapter, it was mentioned that because of physical separation and the unique relationship between foreign subsidiaries and the home office, MNCs are very concerned with the performance of their dispersed global operation. One way to reduce the level of concern is to centralize the most critical decisions at headquarters. The most obvious and easily centralized decisions are those dealing with finance. Through a budgeting system, most of the activities of the subsidiaries are translated into financial reports and are available for closer scrutiny.

Control Approaches

The three approaches to control are the market approach, the rules approach, and the cultural approach. Based on the ideas of Ouchi and Maguire,¹⁰ Lebas and Weigenstein¹¹ proposed that the three approaches form a triangular continuum along which organizations use a combination of two methods of control: input control and output control (Figure 9.1). The three approaches do not exist in pure form. Each, however, may be a dominant form in a given organization. Among the three approaches, as we will argue, cultural control may be needed to respond to the uncertainty and complexity of the international environment.

Market Approach

Control mechanisms employed in a market approach are external market forces. Competition, supply and demand, and contractual agreements are among the external forces that govern the relationships among organizational units. An MNC using the market approach resembles a federation of autonomous units that are free to deal with internal (other units and subsidiaries) or external suppliers. Output control is the dominant method in a market approach, which includes transfer pricing, bargaining, and management compensation. The market approach is efficient in situations where performance requirements are clearly spelled out and various goals are not compatible with one another (p. 129).¹² The market approach seems to be a more practical way to implement control in MNCs. Some researchers¹³ have even advocated the use of internal markets as an ideal model of corporate management by creating what they call *the democratic corporation*, in which corporate headquarters impose minimal constraints on their profit

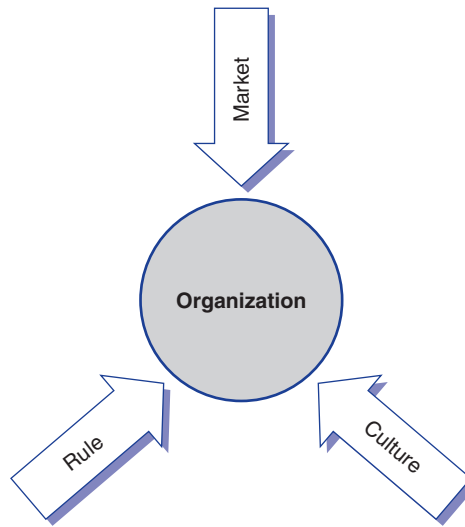


Figure 9.1 Three Control Approaches

centers or subsidiaries. The full benefit of international operations, however, can only be realized through coordination and integration of the activities of dispersed subsidiaries. This in turn necessitates the active management of internal and external resource flows as headquarters' means of exercising control. Resource flow as a control method will be discussed later.

Rules Approach

In most organizations, the rules approach seems to be more visible than other controls. A rules-oriented organization uses both input and output controls. It relies extensively on established rules and procedures, such as planning, budgeting, formal reports, performance evaluation, and hierarchical structure. Rules work best when both goal incongruence and performance ambiguity are moderately high and when the environment is relatively stable. When there is less congruence among the various goals pursued by the members, a rules-oriented control system provides a common ground for action and coordination. In a relatively stable environment, rules provide the specifics needed to clarify goals and performance requirements. A rules-oriented system will only be viable when the environment allows sufficient time to respond to feedback information when corrections are needed. Of course, environmental conditions, and particularly those of the international environment, are unstable. Often, there is not enough time to make corrections and adjustments. Therefore, very seldom does the feedback process of error-information-correction work well for MNCs.

Cultural Approach

In a cultural approach, external rules and procedures are internalized. Instead of the supervisory surveillance that is common in a rules-oriented organization, individuals exercise self-control and abide by cultural norms and expectations. Less time is needed to respond to feedback information, and the cost of control is lower than is the case in the other two approaches. Also, culture is a vital factor in the globalization of the firm. It facilitates control over foreign operations.¹⁴

The most common example of the cultural approach is found in Japanese organizations. In terms of structure, Japanese organizations are generally more loosely organized. Group norms and peer pressure, as well as the desire of individuals to be good group members, are the main tools used for control. Consequently, Japanese firms have fewer bureaucratic procedures than do many of their Western counterparts.¹⁵

The shortcomings of other control systems make the cultural approach more attractive for MNC operations. Because of their specificity and narrow scope, and the required response time, rules-oriented controls have a narrow application and are tied to an organizational unit. There are always exceptions to the rules with which upper-level managers have to deal. Since MNCs operate in a dynamic environment, the market and rules approaches will have limited applicability, and MNCs will need to make increasing use of cultural controls. Since the efficiency of the market approach depends on clearly defined performance requirements and a high level of compatibility among various goals, the market approach cannot be very effective for organization-wide application and for dealing with the global economy in which MNCs operate.

When, through cultural controls, the norms, values, and goals of the organization are internalized, there is no need for personal supervision or formal rules. Since they are not narrow and specific, when applied to input and output controls, cultural norms are applicable on an organization-wide basis. The internalized values provide guidelines that are broad enough to cover most situations. These guidelines allow individuals to follow cultural norms where the ambiguity of the situation renders rules and established standards inappropriate—for example, in budgeting and performance criteria. People's knowledge of these broad informal rules enables them to project them into new situations and to act quickly (p. 264).¹¹ Therefore, compared with the market and rules approaches, the cultural approach to control provides a better ability to handle the performance ambiguity characteristic of MNC operations.

Ouchi explains the limitations of the market and rules approaches and describes the advantages of a cultural approach.^a He builds his argument on the informational prerequisites of each approach, which are prices for the market approach, rules for the rules approach, and internalized values for the cultural approach. Prices charged for intrafirm business transactions are the basis for control in a market system. Rules and procedures form

a foundation for control in a rules-oriented system. Internalized values and norms are the basis for control in a cultural approach.

Prices are a highly *sophisticated form of information* [italics added] decision making. However, correct prices are difficult to arrive at, particularly when technological interdependence, novelty, or other forms of ambiguity obscure the boundary between tasks or individuals. Rules, by comparison, are relatively *crude informational devices* [italics added]. A rule is specific to a problem, and therefore it takes a large number of rules to control organizational responses. A decision maker must know the structure of the rules in order to apply the correct one in any given situation. Moreover, an organization can never specify a set of rules that will cover all possible contingencies. Instead, it specifies a smaller set of rules which cover routine decisions, and refers exceptions up the hierarchy where policy makers can invent rules as needed. (pp. 138–139)¹²

The amount of information required by both the market approach and the rules approach is huge. Compared with these approaches, the cultural approach has minimal informational prerequisites. Cultural norms and expectations are implicit, rather than explicit, rules that govern behavior. They prescribe performance and evaluation requirements in a general way, which must be interpreted in a particular situation. These norms, however, “in a formal organization may produce a unified, although implicit philosophy or point of view, functionally equivalent to a theory about how that organization should work. A member who grasps such an essential theory can deduce from it an appropriate rule to govern any possible decision, thus producing a very elegant and complete form of control” (p. 139).¹² The characteristics of the three approaches are summarized in Table 9.1.

Cultural control has the potential to be very effective in dealing with the diversity, complexity, and uncertainty of the MNC environment. MNCs, however, cannot totally abandon market and rules approaches. Creating culturally based controls takes a long time; cultures are not built overnight. Also, cultures change very slowly, whereas most environmental conditions are subject to sudden changes. Additionally, MNCs comprise diverse people. Diversity always

Table 9.1 Characteristics of Control Approaches

Control Approach	Dominant Method of Control	Information Prerequisite	Scope
Market	Output	Prices	Wide
Rule	Input/output	Rules	Narrow
Cultural	Input/output	Norms and expectations	Wide

makes it difficult to create uniform cultural norms. Therefore, it is impractical for the MNC not to apply other means of control and wait for the development of a corporate culture and the accompanying cultural controls. Moreover, it is important to acknowledge the influence of cultural diversity on the effectiveness of the market and rules approaches to control. In the following, we elaborate on this aspect of cultural control.

The effectiveness of various control systems is influenced by the cultural differences among nations. Because of cultural differences, for example, the usefulness of different control mechanisms could vary in the United States and in European and Asian countries. In a country such as France, for example, where hierarchical authority is more readily accepted, “a vertical organizational structure, minimal lateral relationships, dependence on chain of command, and rules and procedures set by superiors are natural control system components” (p. 266).¹¹ A market-oriented or cultural control system may be more appropriate in a country such as Sweden, where inequalities among the members are minimized and participative decision making is favored. In traditional societies, which avoid radical departures from established norms and where resistance to change is strong, such as in some Asian countries, people prefer the specificity of rules and regulations. Therefore, organizational hierarchy and formal authority could be an effective control system. Cultures also vary in their emphasis on the role of individuals in society. Where individualism is dominant, a market-oriented control may function better. In contrast, where the individual’s concerns are subordinate to the collective interests and benefits of groups or institutions, a culture-oriented control system may be more applicable.

Cultural Aspects of MNC Control

Culture is the most effective control mechanism. Societies effectively manage and control their people by devising cultural controls. Through the socialization process, members internalize the values and norms of society, which become the criteria for judging behavior. The internalized values are also strong motivating forces that induce people to behave according to society’s expectations. Organizations employ culture and socialization for control purposes too. Because MNCs operate in culturally diverse environments, the challenge, however, is to build a control system that capitalizes on the synergy of cultural diversity.

Corporate Socialization

Corporate socialization could be described as the process by which members learn what behaviors and perspectives are customary and desirable in the work environment.¹⁶ Through the corporate socialization

process, new members “learn the ropes” and are indoctrinated with the basic goals of the organization, the preferred means of goal achievement, the responsibilities of the members, the behavior pattern required for effective performance, and the rules for the maintenance of corporate identity and integrity.¹⁷

Corporate socialization takes place through a combination of obvious and subtle means. The obvious means of corporate socialization include job rotation, management development programs, and informal company-sponsored events. Of course, the corporate reward and compensation system is an obvious and powerful tool for shaping employee behavior and promoting the socialization process. A subtle socialization process encompasses the interaction and interpersonal relationship of top management with colleagues and the rest of the employees. The socialization process is closely related to the values inherent in the corporate culture. In this vein, corporate culture is both a reinforcing mechanism and an ever-present instrument of corporate socialization.

For a domestic firm, socialization of employees is a relatively routine process. Almost all organizations establish “the way we do things around here.” Every management veteran has stories to tell about the process of breaking in new employees, a process that makes future control less troublesome. One manager’s strategy of dealing with what he considered unwarranted arrogance on the part of new engineers, for example, was to demonstrate to them their lack of practical knowledge and their dependence on experienced managers.

He would ask the new engineer “to examine and diagnose a particular complex circuit, which happened to violate a number of textbook principles but actually worked very well. The new [engineer] would usually announce with confidence, even after an invitation to double-check, that the circuit could not possibly work. At this point the manager would demonstrate the circuit, tell the new [engineer] that they had been selling it for several years without customer complaint.” Then, he would direct the engineer to explain why it did work. None of the new engineers he had tested were able to do it but were convinced of the need for supplementing their textbook knowledge with practical know-how. From then on, establishing a good give-and-take relationship with the new engineer would be easy (p. 214).¹⁷

The dispersed operations of an MNC make the socialization process more difficult and challenging. Aware of the challenge, many MNCs use job rotation to introduce employees early in their careers to the firm, the culture, and “the ropes” around their global operations. For example, to demonstrate that contrary to employees’ perceptions, international experience was not a roadblock to career advancement, General Electric revamped its job rotation program. It started sending its brightest stars on foreign assignments rather than the run-of-the-mill managers it used to pick for posts abroad.¹⁸ Motorola is another U.S. MNC with a similar program. Motorola has included foreign engineering recruits in its job rotation program. The program is designed to permit its operation in the People’s Republic of China to put up to 20 top recruits into leadership training and rotate them through its worldwide operations.¹⁹

Evolution of Coordination and Control of MNCs

Because of the additional coordination and control difficulties that MNCs face, they need more sophisticated control mechanisms than are used by domestic firms. The need to respond simultaneously to the different strategic requirements of foreign countries demands much flexibility. MNCs have to be flexible in order to take advantage of global opportunities while remaining responsive to local differences. This calls for developing a much more sophisticated control mechanism. Consequently, in addition to formal means of control and coordination, MNCs need to rely on a wide range of informal mechanisms,²⁰ including informal networks of communication, corporate culture and socialization, and career path management (p. 500).

As the international competitive environment changes, so does the MNC's strategies and operations. The implementation of new strategies and the management of new operations require different methods of coordination and control from those used in day-to-day management. As a result, the MNCs' coordination and control tactics are an evolutionary response to their environmental circumstances. The historical evolution of the international environment and the corresponding pattern of coordination and control mechanisms used by MNCs are summarized in Table 9.2. As Table 9.2 shows, over the years, emphasis has shifted from simpler to more complex coordination and control mechanisms.

The evolutionary changes in the international business environment can be divided into three periods (pp. 500–508).²⁰

Period I (1920–1950) brought about political changes that discouraged international competition and were conducive to competition on a country-by-country basis. Forces that restricted international business activities included nationalist sentiments, protectionist barriers, and communication and transportation difficulties. The strategic response to environmental imperatives was the establishment of semi-autonomous businesses within each country. European firms, in particular, adopted country-centered strategies. They organized a decentralized, loosely connected federation of independent national subsidiaries. Each subsidiary served its domestic market. They did not seek to integrate local subsidiaries into a total corporate operation; these local subsidiaries were nationally responsive firms. The management of a federation of semi-autonomous firms needed little coordination and control. MNCs managed their foreign subsidiaries as a “portfolio” of investments. As long as the subsidiaries were generating earnings, they were left to the discretion of expatriate managers. These managers were the equivalent of “Roman proconsuls that were given responsibilities only after years spent absorbing the values and practices of the parent company” (p. 118).²¹ Headquarters control was ensured through loyal expatriate managers who provided an informal link with subsidiaries and preserved the corporate management style even in faraway countries. Direct

Table 9.2 Historical Evolution of the International Competitive Environment and Corresponding Coordination and Control

Pattern of International Competition	Strategic Response of MNCs	Coordination and Control
Period I: 1920–1950		
Multidomestic (or Country-by-Country Basis)	Country Centered	Limited Control and Coordination
Competition in each country is essentially independent of competition in other countries	<p>Direct investment in many countries</p> <p>Self-contained and autonomous branches</p> <p>Differentiated and responsive strategy</p> <p>Competitive advantage in mainstream value activities</p>	<p>MNCs manage their activities as portfolios of subsidiaries (especially Europeans)</p> <p>No integration</p> <p>Decentralized federation of national subsidiaries</p> <p>Periodic financial reports</p>
Period II: 1950–1980		
International	International	Formal
International MNC's competitive position in one country is strongly influenced by its competitive position in other countries	<p>Concentration of production in few plants to achieve scale economies</p> <p>Serve the world from these few manufacturing locations through exporting</p> <p>Centralized control of worldwide marketing activities</p> <p>Standardization of product design</p>	<p>Budgeting, standardized programs (e.g., marketing, manufacturing)</p> <p>Centralized R&D</p> <p>Structural mechanisms: product divisions, regional divisions</p> <p>Centralized "hub"</p> <p>Output control</p>
Period III: 1980–		
Global (or Worldwide Basis)	Global With Increasing Foreign Investment	Formal and Informal
MNC's competitive position in one country is strongly influenced by its competitive position in other countries	<p>Decentralization of production in many plants in the world, each specialized in processes and/or products, with a strong interdependence among them</p> <p>Interorganizational transfer of technology and ideas</p> <p>Simultaneous response to national interests and local needs and to economic forces toward globalization</p>	<p>Period I and II mechanisms, plus task forces, committees, integrators</p> <p>Informal communication networks</p> <p>Socialization of home-country and foreign managers</p> <p>Corporate culture</p>

SOURCE: Adapted from Reference 20 (Tables 4a and b, pp. 504–506).

reporting of subsidiary managers to the head of the MNC was a formal means of control exercised by headquarters. Subsidiaries supplied the headquarters with periodic financial reports, assuring headquarters that they were keeping in line with the profit objectives of the MNC.

The international environment during Period II (1950–1980) represented a reverse of the conditions in the previous period. Economic and political forces favored international competition. Advancements in production technologies increased economies of scale. Decreased transportation and communication costs, along with economies of scale, allowed concentration of production in low-cost countries. These developments combined with the easing of protectionist barriers to increase international competition. MNCs responded by adopting an international strategy in which decision making was highly centralized and foreign subsidiaries were tightly controlled from headquarters. In terms of control, the MNCs relied on formal mechanisms, centered on budgeting, and on standardized programs in manufacturing and marketing. In addition to frequent financial reports, subsidiaries provided the headquarters with reports on all major functional areas. Formalization and standardization of policies, rules, and procedures strengthened headquarters' tight output control over subsidiaries' operations.

Currently, MNCs are experiencing the environmental changes of Period III (1980–present), which are challenging their coordination and control capabilities. In the early 1980s, conflicting demands began to create a new set of pressures on MNCs. On the one hand, technological developments resulted in the globalization of business and competition in many industries. On the other hand, many governments demand that MNCs invest locally to create jobs, transfer technology, and contribute to the balance of payments. These factors plus a rise in nontariff barriers and protectionist tendencies called for local responsiveness. In turn, the contradictory demands of global strategies and local responsiveness required a higher level of coordination and control. MNCs discovered that the hands-off approach that relied on formal control and coordination mechanisms, used in the first two periods, was inadequate for Period III. Recognizing the need for flexibility and responsiveness, they instituted both formal and informal control mechanisms. In addition to the formal controls of previous periods, MNCs are now using informal and subtle means that overlap existing organizational structure and formal reporting procedures. Included among the new control mechanisms are teams, task forces, committees, and integrators. Additionally, the free flow of informal communication among all managers—from their headquarters to subsidiaries and vice versa and among the foreign subsidiaries—supplements the formal communication channels. Philosophical changes at their headquarters allow MNCs to offer career paths that enable all managers, regardless of their country of origin, to advance to positions previously reserved for home country executives. In doing so, the MNCs create a corporate culture that

effectively controls managerial actions without a reliance on formal rules and procedures. Acculturation of these managers, through continuous assignments to key positions throughout the global operation of the MNCs, works to develop a strong corporate culture and induce the internalization of organizational objectives, values, and beliefs and the corresponding policies and procedures.

Of course, this chronological progression in the application of control mechanisms is not uniform among all MNCs. Technological developments and the competitive forces of the industry, among other factors, may propel a firm to use specific control mechanisms. The trend toward globalization, however, has been compelling MNCs to abandon the less appropriate control mechanisms of earlier periods. Also, MNCs may not change their structural and formal tools of coordination and control but may additionally establish more informal mechanisms hidden under the surface. Procter & Gamble and Unilever, for example, have not significantly changed their formal coordination and control mechanisms for a long time. Instead, the internal management processes have changed. “Subsidiaries have assumed new and specific roles to respond to changing local conditions, and the headquarters’ control mechanisms have evolved from ubiquitous ‘company ways’ to multidimensional gestalts that are applied differently to different parts of the organization” (p. 620).²²

Control by Standardization

Prior to the advent of globalization, many MNCs, such as Whirlpool, grew in different national markets without much integration and without the benefit of standardization across products and markets. This is a luxury that globalization has made impossible to afford. Now, to compete globally, successful MNCs implement product/market standardization as a means of controlling the operations of dispersed subsidiaries. In its attempt at standardization, Whirlpool determined that its products, such as dishwashers, refrigerators, and other household durable products, had two groups of major components. The first group, which consumers did not see, consisted of subsystems and parts that were common among all, such as electric motors and fans. Because this group was culture-free and was not affected by consumer taste and preferences, it could be standardized as platforms. The second group, which consumers could see, such as size, color, and exterior design, was affected by local tastes and preferences. This group could not be standardized but could be added and built into the standardized platform. In doing so, the number of platforms worldwide was reduced from 135 to 65. As a result, annual development costs were reduced by 10% and purchasing parts by 30%.²³

Additional Control Problems of MNCs

In addition to the control problems associated with managing dispersed subsidiaries in economically and politically diverse environments, MNCs also encounter several other specific control problems:

1. Language and cultural differences
2. Geographic distance between the headquarters and subsidiaries
3. Legal differences
4. Security issues
5. Intrafirm business transactions (transfer pricing)
6. Currency exchange rate fluctuations

Currency exchange rate fluctuations were briefly discussed in the chapter on strategy. In the following, we discuss the other control problems of MNCs.

Language and Cultural Differences

Diversity in language and culture among various foreign operations is the source of many of the difficulties the MNCs' headquarters encountered. Some of the problems can be reduced by assigning expatriates who are "acculturated" at headquarters to key managerial positions in the subsidiaries and identifying local managers who are proficient in the language of the headquarters. Typically, however, most staff at headquarters have limited or no foreign language skills, and the language problem remains real. The result is that communication between much of the headquarters staff and foreign subsidiaries is limited to contacts with those subsidiary personnel who can speak the language of the headquarters. This reality reduces the amount of information the headquarters staff receives and processes. Without the ability to directly reach the sources of most information, they are at the mercy of subsidiary staff who have language skills or interpreters.

This problem is magnified if several languages are spoken by the local workforce. Such is the case in Africa and India. Even in European countries, which employ a large number of guest workers, control problems arise from the linguistic variety. In Germany, for example, many plants employ guest workers from Spain and Turkey, as well as the local German workers. The codetermination laws (covered in the chapter "International Labor Relations") require periodic meetings with workers. These meetings are held in Spanish, in Turkish, and, of course, in German. Additionally, the German subsidiaries of American firms that have American general managers hold top management meetings in English (p. 36).²⁴

Language diversity often creates fewer strategic and more operational control problems. In part, it is typical for upper-level managers to be involved in

strategic control, and there is a higher level of foreign language proficiency among this group of managers. In contrast, there are two reasons why language diversity creates problems in operational control, particularly in developing countries. First, and as noted, operational control affects more lower-level foreign subsidiary personnel, and they are less likely to be proficient in the MNC's home country language. Second, since language and culture reflect the level of technological development, the languages of many developing countries do not have equivalents for the technical, industrial, and commercial terms used in modern business enterprises. Often, it is impossible to translate these terms into the local language. The use of a common language, which in most cases is English, is very difficult for a workforce with minimal education and may require the MNC to institute language-training programs. To overcome the language problem for servicing its equipment, for example, Caterpillar has devised a unique method. They have developed an 800-word vocabulary called Caterpillar Fundamental English. With this tool, it is possible for local suppliers, dealers, and service personnel to work with Caterpillar equipment without the need for a translation.²⁵

Even without language difficulties, cultural differences have the potential to create control problems. Cultural norms and role expectations may result in inaccurate information and misunderstanding. Criticism in public, for example, is avoided in most Asian cultures; therefore, on-the-spot suggestions for improvements may not produce the intended results. Group harmony and cohesion are very much valued in many Asian countries. Consequently, people from these cultures may not report problems to higher levels immediately, hoping instead to find a solution without unduly disturbing the group.

Geographical Distance

Telecommunication technologies and improvements in transportation facilities have greatly aided the expansion of MNC operations. Vast geographical distances between the MNCs' subsidiaries, however, pose control problems that even today's modern telecommunications and ease of travel have not been able to fully overcome. Nothing can substitute for face-to-face communication and personal visits. Written communication, telephone calls, and voice and computer messages are not the same as personal visits. Often, to travel from headquarters and visit a foreign subsidiary takes at least a couple of days and much advance preparation. Distance matters even within a host country.²⁶ When an MNC has a number of business operations in a country, the physical distances between them can have a negative influence on the ease with which headquarters manages them. In some cases, this added travel time permits host country staff to rig personal visits by headquarters to show a different and rosier picture of the operations. Consider the following incident.

An American paint manufacturer gave a foreign importer in an Asian country exclusive regional distribution rights. The importer was supposed to

act as a middleman between the retailers and the paint company. Therefore, by contract, he was not permitted to be a retailer as well. In violation of the contract, the importer had established a full retailing operation and in effect had become a monopoly. He had set up a bogus wholesale office, separate from his main business, which would be temporarily staffed only when he was expecting a visit from headquarters. Language barriers and long physical distance allowed this masquerade to go on undetected for a few years.

Legal Differences

Although a whole chapter is devoted to the legal aspects of international management, here we briefly examine some major legal problems with MNC control. Laws and legal procedures are central to the concept of organizational control. The control of a business firm depends on the legal institutions and practices of the host country. The practices that legally are accepted or rejected in one country are not necessarily honored or rejected by another. An MNC's control of foreign subsidiaries can take place only within the confines of the legally accepted business norms of host countries. In effect, a host country's legal system may place limitations on the control that headquarters can exercise. In Germany, for example, most firms, including MNCs, are bound by codetermination laws, which require the membership of labor representatives on boards of directors. Because the law dictates power sharing and sharing of organizational control between management and labor, managers cannot unilaterally make certain decisions, such as to close a plant.

The host country's legal requirements in virtually all aspects of business operations, including labor relations, finance, marketing, and manufacturing, limit MNCs' control over subsidiaries. Some countries limit the equity ownership of domestic firms by MNCs. Equity ownership limits are more common among developing countries. In these countries, instead of direct control over the operations of the subsidiary, MNCs may assume the minority position and may have to rely on advice and persuasion. The major problems of sharing equity ownership with host countries are discussed in a subsequent section.

Security Issues

Most nations have benefited from globalization. However, increased international trade; the information explosion, including the use of the Internet; and increased immigration have also made it easier for various groups to engage in terrorism. Terrorism adversely affects international business and poses serious questions regarding control of MNC operations. For a long time, developing countries had certain concerns over the loss of control to MNCs. Now, developed countries are facing a similar dilemma, albeit

of a different nature. Europeans and especially Americans are uneasy about, if not completely against, handing over to foreigners the management of firms they consider either national jewels or subject to security concerns. A number of European countries, for example, have blocked the takeover of local firms even by MNCs from other European countries.

The issue of national security as it relates to increased acts of terrorism has become a very sensitive and important matter in the United States after the tragedy of September 11, 2001. Experts have been sounding alarms about securing the nation's borders and particularly its ports.²⁷ The issue of port security drew a very strong uproar after the purchase of a British firm, which operated five terminals at U.S. ports, by Dubai Ports World (DPW). DPW is in the United Arab Emirates, a country south of the Persian Gulf. Some argued that this event might create, in the minds of international investors, a country risk for the United States similar to those of politically volatile developing countries. Such a development could disrupt an increasingly interdependent world economy. It might discourage foreign investment in the United States, on which the country is heavily dependent. An outcry against similar big acquisitions in Europe raised concerns about a rise in economic nationalism and a backlash against globalization.²⁸

The national security issue of MNCs' control can be viewed from the perspectives of **economic benefits** and **less favored nations**.

First, from the **economic benefits** point of view, control of MNC operations grants decision-making authority and, ultimately, distribution and the use of revenues. Previously, this aspect of control was thought to be directly related to ownership rights. This assumption, however, proved to be less critical when it was tested against the sovereign power and rights of host governments. Developing countries learned that even without ownership rights, they could use their sovereignty to achieve their strategic goals. Earlier, this was discussed under the topic of creeping expropriation. This characteristic of control is more relevant to developing countries. Host governments of developing countries are interested in influencing MNC decision-making processes and steering those decisions in a desired direction that serves their strategic goals. Developed countries, however, often allow free-market forces to govern this feature of control.

Second, the **less favored nations** view is a more recent phenomenon that has attracted the attention of experts and scholars.^{29,30} The rise of international terrorism has made the control of MNC operations a national security issue. International terrorism has negatively affected the operations of all MNCs. Some MNCs, however, have been more severely affected. With or without merit, MNCs with their headquarters or owners in certain countries have been negatively affected by this issue. From this perspective, certain MNCs should not be granted the opportunity to manage and control business enterprises, if such operations pose national security concerns. An example of this type of control feature was underlined when the sale of the laptop computer division of IBM went through a very rigorous examination by the U.S. Congress. Another example was the case of DPW.

It is the second perspective of MNC control that will be discussed by international scholars and security experts for years to come. In the future, this feature of MNC control will become more likely to influence host country–MNC relationships.

Intrafirm Business Transactions

Firms can use various strategies for entering into foreign markets, including exports, contractual agreements, and direct investment. An export-oriented firm is dominated by product flows from the home country to foreign markets. The flow of capital from the home country to host countries characterizes firms using investment as an entry strategy. Knowledge flows from MNCs to host countries through licensing and contractual agreements. Within this context, therefore, an MNC could be viewed as a network of resource (products and components, capital, technology and knowledge, and personnel) flow across national borders among business units controlled by the headquarters. In this network, resources flow from the MNC's headquarters located in the home country to subsidiaries in foreign countries. Additionally, there are intersubsidiary business transactions that are controlled by headquarters.

Because the flow of resources among various units of a domestic corporation takes place within national boundaries (i.e., where the firm manufactures in one area of the country but sells its products in others), it creates no special problem. The same is not true for MNCs. In some countries, MNCs cannot fully exercise their property rights. Various host government restrictions imposed on the MNCs limit the free flow of resources among subsidiaries. When repatriation of profits is restricted by host governments, for example, control and exercise of property rights on corporate earnings are limited. Some countries go even further and establish production and export requirements for MNCs, which effectively curtail operational control over their subsidiaries. China, for example, requires most MNCs to export a significant portion of their production that takes place in China.

Global Control

A couple of decades ago, Black & Decker (B&D), the U.S.-based hand tool manufacturer, was faced with competition from Makita, a Japanese company that was producing and marketing standardized, low-cost products globally. Makita was able to compete both on prices and on quality, resulting in a substantial increase in its market share. Prior to 1985, B&D had an assortment of extremely independent subsidiaries.

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(Continued)

The British, French, and German subsidiaries manufactured products independent of one another's input and sold them locally. Standardization was nonexistent. Diversity of products, parts, and components was enormous, with over 100 different motors across the globe. This, of course, had created massive overhead.

A new strategy to control costs, improve quality, and recapture market share was implemented. The strategy focused on standardization of products among all subsidiaries for distribution around the world. Motor models, for example, were reduced to 20, with plans to reduce that number to only 5. Improvements resulted in streamlining efforts and more effective production, including time reduction for output. The company also concentrated heavily on innovative design, which resulted in worldwide design recognition. Marketing was made consistent, resulting in a global image that did not vary from market to market. B&D reduced its advertising agency network by consolidating from more than 20 to 2 principal agencies focused on coordination of advertising around the world. Together, these combined strategies resulted in a 30% increase in revenues in a few years (pp. 94–182).³¹

Resource allocation is an effective measure in support of a global competitive strategy (p. 621).³² The complexity and mixed characteristics of MNC activities require the use of standard objective measures for comparison. These measures are characteristic of the market approach. Resources include anything of value and, therefore, comprise not only the flows of finances and products but also the flows of technology, people, and information. The pattern of resource allocation among foreign subsidiaries is an important means of control. This is particularly important when dealing with some developing countries where sociopolitical instability and capricious government policies are often the source of political risk.³³ To reduce political risk, the control of resource flow is considered an effective strategy. MNCs can exert substantial control even from a minority ownership position through the flow of technology, management know-how, and control of export-marketing channels.³⁴ Centralization of research and development (R&D) activities at the headquarters is a common and effective means of control that ensures the dependence of foreign subsidiaries on headquarters. For this reason, MNCs, in many cases, are very reluctant to establish R&D facilities outside their headquarters. Prior to the 1970s, oil-producing countries that had nationalized MNC operations were forced to invite the MNCs back because the local governments lacked the technological and managerial capabilities to run the very industries they had nationalized. Similarly, export-marketing channels were dominated by global oil

companies at that time. Those dominating companies effectively manipulated the situation against the risk of nationalization.

Furthermore, resource flow patterns between headquarters and the subsidiaries, on the one hand, and between the subsidiaries, on the other, raise special control issues. Although the pattern of resource flow is mostly from the MNC headquarters to subsidiaries, increasing globalization of business and diffusion of technology are beginning to alter this arrangement. An MNC may find it necessary to concentrate certain aspects of its business in a particular country. In the microcomputer industry, for example, it would be beneficial to locate R&D facilities in Silicon Valley (San Jose, California). Proximity to, and interaction with, a large number of firms at the cutting edge of a new technology provides easy access to a highly qualified workforce and immediate knowledge of the latest developments. A foreign subsidiary located in Silicon Valley could become responsible for the supply of advanced technology to the rest of the company. The dependence of various units of the MNC on this subsidiary for technology increases the subsidiary's importance to the MNC and along with it the amount of attention and scrutiny it receives from the company's headquarters. In fact, internal resource interdependence is believed by many researchers to have a very important influence on decision-making patterns within the various units of an MNC (p. 32).³⁵ Some even consider headquarters' resource dependence on subsidiaries to be the most important determinant of subsidiary autonomy (pp. 893–908).³⁶ Examination of the relationship pattern between a headquarters and its subsidiaries suggests that the higher the importance of a subsidiary to the parent MNC and the rest of the firm, the lower its decision-making authority. The more a parent company delivers to and receives resources from a subsidiary, the more the critical decisions, such as investment and finances, that are concentrated at its headquarters. Thus, there is a negative relationship between the importance of a subsidiary to the MNC and its decision-making authority (p. 33).³⁵

The pattern of intrafirm resource flow could be used to chart the decision-making autonomy of MNC units. Figure 9.2 illustrates the pattern of intrafirm business transactions along a two-dimensional model (patterned after Ref. 37). One dimension of this model is the flow of resources from a subsidiary to the rest of the MNC, and the other dimension is the flow of resources from the rest of the MNC to the subsidiary. Four types of subsidiaries are represented in this model: net supplier, net receiver, balanced subsidiary, and marginal player. A net supplier sends more resources to the rest of the MNC than it receives. A net receiver is just the opposite of a net supplier; it receives more resources from the rest of the MNC than it sends to them. There is a roughly equal inflow and outflow of resources between the balanced subsidiary and the rest of the MNC. A minimal number of business transactions with the rest of the MNC characterizes a marginal player.

Based on this model, there could be variations in a subsidiary's importance and autonomy within the MNC. A subsidiary's importance to the multinational network and to the headquarters is predicated on where the subsidiary stands on the overall pattern of resource flows. Generally, those subsidiaries

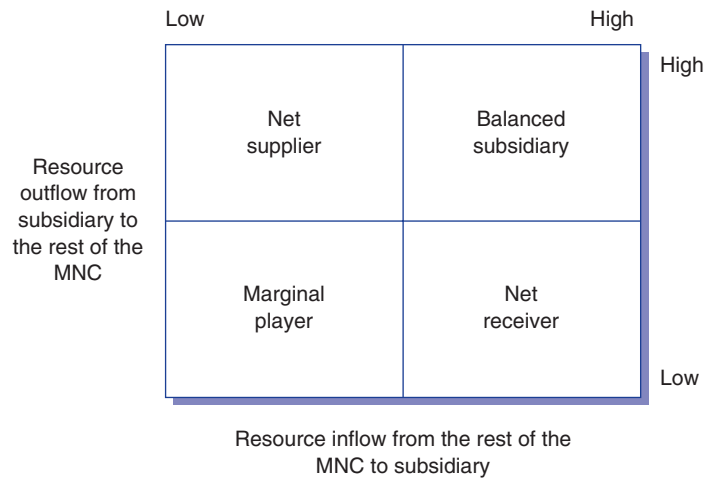


Figure 9.2 Intrafirm Resource Flow

that provide and receive a high volume and value of resources are considered more important to the MNC. Similarly, those subsidiaries that provide and receive few resources are considered marginal to the interests of the corporation. Subsidiaries that provide more than they receive and receive more than they provide have an importance in between that of the balanced subsidiary and the marginal player. Looking at this from the MNC's point of view, one may make the argument, based on standard rules and norms, that the more important type of subsidiary is the balanced subsidiary. Similarly, one may make the argument that the relatively less important type of subsidiary is likely to be the marginal player. Extending this line of thinking, the net supplier is likely to be more important than the net receiver. The reason the net supplier is more important to the headquarters than the net receiver is that an interruption of resource flow from the net supplier could affect the rest of the MNC's operations, while any interruption of resource flow to the net receiver could affect the net receiver's operations only. The net receiver, in turn, is likely to be more important than the marginal player. Both the net supplier and the net receiver are less important than the balanced subsidiary. All other things being equal, the importance of a subsidiary to an MNC's operation is directly related to the amount of resource (value and volume) inflow and outflow that occurs between the subsidiary and the rest of the MNC. On this basis, a balanced subsidiary will be more closely controlled than the other subsidiaries, and marginal players may be afforded considerable freedom from controls. Table 9.3 depicts these relationships.

Other Factors

The pattern of resource allocations and the amount of control exerted by the headquarters is determined by many factors; among them are the importance

Table 9.3 Resource Flow, Subsidiary Importance, and Headquarters Control

	Resource Flow to Subsidiary	Resource Flow From Subsidiary	Importance of Subsidiary to Headquarters	Control Exercised by MNC
Marginal player	Low	Low	Very little	Very little
Net receiver	High	Low	Some	Some
Net supplier	Low	High	Moderate	Moderate
Balanced subsidiary	High	High	Very much	Considerable

of a subsidiary to the MNC and the required relationship between the subsidiary and the host government. A subsidiary, for example, may be given more decision-making authority if it has to establish certain links with the local community and to do so, it requires more autonomy. Also, a headquarters' confidence in the managers of its subsidiaries determines the amount of central control it exercises over them. The MNC's confidence is a function of a manager's skills, experience, and nationality. More experienced and competent managers are given more decision-making authority. Also, expatriates have more autonomy than host national managers.

Ownership and Host Government Involvement

In discussing control concerns of multinational corporations, two separate, but interrelated, issues stand out. The first one is the control of organizational performance as just discussed. It deals with the activities and operation of the enterprise and provides information and assurances that the corporate plans have been accomplished. Typically, it is the control of organizational performance that comes to mind when discussing the subject of control. The second issue is the legal and ownership control that deals with business-government relationships and participation of the host country in the ownership of a foreign subsidiary. The legal and ownership issues of control are even more challenging and complex than those involving corporate strategies.

Host Government Involvement

Host governments regularly interfere in the normal business operations of MNCs and infringe on their decision-making power and control, typically getting involved with the subsidiaries rather than at the headquarters level. Consequently, the amount and type of control exercised by the headquarters over foreign subsidiaries are altered as host government involvement increases.

Host government interference falls into three major categories: financial and investment decisions, business decisions, and human resource management (pp. 13–14).³⁸

Financial and Investment Decisions. The most prevalent demand by host governments is for financial participation in foreign subsidiaries. Particularly in Asia and South America, host governments pressure MNCs to share equity ownership of their subsidiaries with domestic investors or host government agencies. Under pressure, some MNCs succumb to these demands. Most MNCs do not strongly object to a minority equity ownership by locals. In fact, sharing ownership with host country investors is an effective protection against host government policy decisions that could adversely affect an MNC's operations. Some MNCs, however, have refused to do business with countries where they are not permitted to assume a majority equity ownership. From the MNCs' point of view, effective control of a business is much easier with a majority equity position.

Interference in repatriation of assets is another financial restriction imposed on MNCs. Some host governments limit repatriation of MNC assets. This limitation is considered most troublesome by MNCs because it severely curtails their investment strategies and forces them to reinvest in the host country. Reinvestment in the host country may not necessarily be the best alternative. Asset repatriation restrictions are more common among developing countries with growing markets.

Another financial decision that is a source of contention with host governments is the allocation of R&D expenses to foreign subsidiaries. Some host governments have policies limiting the amount of fees that MNCs can charge their foreign subsidiaries for R&D work carried out by their central laboratories. Another R&D issue is the location of research facilities. All countries, particularly developing nations, are very interested in technology transfer and demand that MNCs establish research laboratories in the host countries. Not only are R&D facilities a source of new technology, but they also contribute to the improvement of skills and knowledge of the local workforce.

Sharing equity ownership with host countries affects utilization, and sometimes control, of MNC's resources. Without full control over a subsidiary, an MNC may be unwilling to use the best available technology. To transfer state-of-the-art technology that could not effectively be safeguarded against pilferage and piracy is not a wise choice. It may not, however, be wise to limit technology transfer. One MNC executive expressed this dilemma in the following terms: "Local participation can interfere with the free flow of the best technology available for each market. When you slow the development of the local units this can sometimes result in the loss of management control over the decision-making process" (p. 18).³⁸ The requirement of a large local equity ownership may reduce an MNC's control over how it maintains and expands a business. In the extractive industries, for example, the full development of a business requires a large investment. In some countries, sufficient

local capital may not be available to meet a 50%, or more, local ownership requirement. In such a case, an MNC may be forced to operate its foreign subsidiary with a less than optimum size. This is also in line with findings that indicate that in a joint ownership arrangement, an MNC's control has a significant positive impact on the survival of its subsidiary.³⁹

Business Decisions. Host governments interfere with business decisions by establishing certain performance criteria for foreign subsidiaries. These criteria include local component requirements, market share limits, tie-in products, and export quotas. Local component requirements involve the demand of many host governments that products sold by MNCs in the host markets incorporate locally produced components or raw materials. The aim is to increase MNCs' contributions to the local economy and employment and to reduce hard currency spending. Host governments are also very interested in regulating domestic competition and preventing MNCs' total domination and control of local markets. Setting a limit on the local market share that foreign subsidiaries can gain ensures the viability of fledgling domestic businesses. Also, tie-in products are used to increase MNCs' contributions to the domestic economy. As a condition for allowing access to the domestic market, a host country may "tie in" by requiring that an MNC produce or sell certain products. These requirements and demands transfer partial control of the business operation from the MNC to the host country and reduce the decision-making authority of the MNC's managers.

Human Resource Management Decisions. A host government's desire to increase the employment, skills, and knowledge of its people is manifested in several ways. The host government may demand that host nationals be appointed to top managerial positions within local subsidiary operations. Compliance with this demand makes the control of local operations more difficult, especially where trust and competence become issues.

MNCs become more cautious and increase headquarters control when they are forced to appoint a host national as the head of a foreign subsidiary. Most MNCs grant more decision-making authority to expatriate managers than to host nationals, and having home country nationals at the head of foreign subsidiaries is perceived to reduce the need for other means of control. When the MNC is strategically dependent on the subsidiary, it is more likely that for control purposes, an expatriate is appointed as the subsidiary's manager.⁴⁰ An alternative effective control technique used by most MNCs is to identify local managers who have internalized corporate values. This requires constant and close monitoring of local managers' development and progress through the corporate hierarchy.

Appointments at lower organizational levels are considered less important. These and other human resource management issues, such as hiring, promotion, and negotiation with locals, are made by the subsidiary. Usually, only important and critical decisions are centralized at the headquarters.

Other matters are left very much to the discretion of the subsidiary. Those decisions that might directly affect the headquarters or other subsidiaries or might influence the profitability of the affiliates or the parent company are closely controlled. Often, these decisions are made exclusively by the parent MNC. Sometimes, subsidiaries are allowed to participate in making these decisions, but the final choice is still made by the headquarters.

Ownership and Control of Foreign Affiliates

Besides the nature of the decisions, other factors influence the centralization of decision making at the headquarters and reduce the autonomy of affiliates. We have already referred to a few of these factors, including the skills and experience of managers and their nationality. Other factors are the size and degree of internationalization of the MNC, the type of product produced by the subsidiary, the markets that the affiliate serves, and the proportion of equity owned by others. From a survey of U.S. affiliates in Mexico and France, Garnier³⁶ concluded that a subsidiary's autonomy is less when

1. it belongs to a large MNC that operates in many countries;
2. its products are fairly standardized;
3. the MNC is fairly integrated, with important intrafirm flow of resources;
4. besides its own home market, it serves other markets as well; and
5. a large portion of its equity is owned by the parent MNC (p. 906).

In business organizations, domestic or international, regardless of the locus of control (centralization vs. decentralization), firms are interested in the full application of the strategic decisions made at their headquarters. Compliance with headquarters' decisions will be higher when an MNC's strategy-making process is judged to be fair by the top managers of its subsidiaries.⁴¹

Five conditions determine the fairness of the strategy-making process:

1. Headquarters is knowledgeable about the local conditions of the subsidiaries.
2. A two-way communication exists in the multinational's strategy-making process.
3. The headquarters' decisions are fairly consistent across subsidiaries.
4. The subsidiaries can legitimately challenge the headquarters' strategic views.
5. The MNC's final strategic decisions are fully explained to the subsidiaries.⁴²

A firm may prefer joint ownership with locals, at the outset of expansion abroad, due to unfamiliarity with the host country environment. At that time, an MNC may not have a majority equity ownership and, therefore, may not have full control over its foreign operations. The MNC, however, can exercise significant control through other means. As it gains experience and self-confidence, it will probably favor creating an integrated global operation that requires majority or full ownership of foreign subsidiaries (p. 32).⁴³ We discussed the Acer Group in Chapter 8, describing the network organization. Acer, a newcomer to global business, at the beginning of its push to become a global company, attempted to independently own and operate subsidiaries listed in the local stock markets. This vision of globalization proved to be very difficult, if not impossible, to implement. The difficulties forced Acer to reaffirm its ownership and control of these regional business units (p. 77).⁴⁴ Of course, even with majority or full equity ownership by MNCs, host governments control a wide range of subsidiaries' operating decisions, such as profit repatriation and expatriate employment.

The ownership pattern of U.S. MNCs indicates that they prefer to retain total ownership of foreign subsidiaries (pp. 32–34).⁴³ The management of a jointly owned foreign operation is a very difficult undertaking. Cultural differences and limited commonality among partners exacerbate the operational and strategic problems of a joint venture. Except for the learning period at the beginning of expansion into a host market, a jointly owned firm is less attractive to an MNC than a wholly owned subsidiary. Sometimes, however, as mentioned before, in a politically unstable environment, a joint venture with host country partners reduces the risk of adverse host country policy decisions. Joint ventures are inherently unstable and subject to frequent “renegotiation” imposed by the majority partner. Usually, through these renegotiations, the joint venture is converted into a wholly owned subsidiary.⁴⁵

It is much easier to manage a firm without having to share decision-making authority with other parties. The preference for full ownership of foreign subsidiaries is therefore almost a direct result of control problems. In a marketing-oriented MNC such as Coca-Cola, for example, where commitment to certain marketing strategies for the global operation is very important and where the firm possesses special marketing skills, a wholly owned subsidiary is preferred. To implement the overall marketing strategy at the subsidiary level, headquarters needs full control. In this case, strategy implementation could be compromised if conflicts arise with the partner over centralized control. Particularly in a transition economy, the delegation of marketing matters to the local staff involves performance risk.⁴⁶

Where control could be exercised by other means than equity ownership, MNCs have shown a considerable amount of practical flexibility. An MNC, for example, may agree to share equity ownership in a joint venture manufacturing project with a host government if it can maintain control by full ownership of sales operations. Consequently, the host government's demand is met, and headquarters maintains control over subsidiary operations.

Summary

An effective control system is needed to manage an organization successfully. In MNCs, control is a much more complex and demanding issue than it is in a domestic business. Unlike a domestic operation, a foreign subsidiary cannot, for long, subordinate its business requirements, which are often dictated by the host country, to those of the parent MNC. An effective MNC control system should allow for local adaptability and responsiveness to the host country environment. A challenging task for MNC top management is to build a control system that, while promoting the overall corporate competitive position, is beneficial to individual subsidiaries as well. In other words, if subsidiaries consider the strategy process and associated control system fair, they will accept it more readily. Subsidiaries' managers consider a corporate strategy more attractive when it includes interests important to the subsidiaries. Moreover, when subsidiaries' interests are not totally abandoned in favor of promoting corporate objectives, the strategy process will be considered to be fairer. This, in turn, provides greater incentive for compliance by the subsidiary and makes corporate control much easier.

Of course, a fair strategy-making process has a built-in control mechanism that is also fair. This means, for example, that if return on investment is used to evaluate the performance of a subsidiary manager, allowances should be made to compensate for the shortcomings of this evaluation technique. Return on investment evaluations do not reflect the impact of decisions made by the headquarters for the benefit of the whole MNC operation. Those decisions may have a negative impact on the subsidiary's earnings.

Various control mechanisms and approaches used by domestic firms are applicable to MNCs. The diversity of the international environment, however, makes it more difficult to apply these controls. Effective MNC control employs a combination of formal, informal, direct, and indirect mechanisms to account for the uniqueness of each subsidiary while addressing the total MNC strategic and operational requirements.

Discussion Questions

1. What are the differences between the control processes of MNCs and those of domestic firms?
2. Describe the various control mechanisms that MNCs could use.
3. What control mechanisms work well for an integrated MNC?
4. Why is MNC control more difficult than the control of a domestic business?
5. Does geographical distance create any difficulty for the control of an MNC?