

# STRATEGIC CONTROL IN INTERNATIONAL COMPANIES: A CASE STUDY

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## ABSTRACT

*Globalization forces companies to look for new markets for their business. On one hand international operations enable companies to use their resources more effectively. But on the other hand, internationalization brings about number of problems associated with the strategic control of subsidiaries. In order to gain competitive advantage from the multinational scope of business, firms should secure the effective implementation of corporate-level strategies and policies while at the same time allow for the right degree of subsidiaries' autonomy. The paper presents the main results of an empirical research of forms and mechanisms of strategic control with respect to market and cross-cultural peculiarities.*

## INTRODUCTION

The strategic aspects of international development, globalization and the opening of new markets attracted remarkable interest of researchers. The problem of adjusting the firm-level strategy while entering a foreign market to the cultural peculiarities of the company's home and foreign cultures has been extensively studied (Barlett and Ghoshal 1995, Kogut 1985, Kogut and Harbir 1988, Levitt 1983, Ohmae 1990, Prahalad and Doz 1987, Duning 1993). The finding of this research was that international expansion strategy depends on several factors, both pertaining to the international context and company specifics.

Another research question that has been studied is "what occurs after the international strategy has been chosen and a company has already entered a new market?" A number of factors which influence behavior of companies after entering foreign markets have been identified (Ghoshal and Nohria 1993, Li 1995; Sharma 1998; Harzing and Noorderhaven 2008; Soledad and Mody 2004, Morrison, Ricks and Roth 1991). At the same time, the problem of executing strategic control of foreign subsidiaries in its relation to cross-cultural issues has not got appropriate attention in the literature.

Thus, the aim of this paper is to analyze, what forms and mechanisms of strategic control become more effective depending on the chosen strategy of international expansion, business environment, culture and market specifics.

## THEORETICAL UNDERPINNINGS

Analysis of existing literature has shown that two aspects of company's international strategy dominate the interest of researchers: choice of international market entry strategy, including its organizational forms, and choice of company's strategic control of its international operations.

### **International expansion strategy**

The decision on foreign market entrance strategy is made at the corporate level. International expansion is usually expected to promote profitability growth in the long-term. The use of advantages offered by operations on foreign markets may be favorable for the attainment of company's strategic goals. These advantages, which are unavailable to the companies working only in their domestic markets, are: economies of scale due to higher production and sales volumes and placing manufacturing facilities in the regions with lower costs. Nevertheless

not all companies make attempts to enter foreign markets. This is because such a strategy requires substantial sophistication of the company's management to handle the political and economic risks of working in foreign markets and of cross-cultural differences in management practices.

There are two main alternatives at the ends of the spectrum (with a number of intermediate options in-between) may be examined from the perspective of standardization of company's operations:

1. *Multinational strategy*, based on accounting for and using of peculiar national features of particular segments of the world market on which the company operates;
2. *Globalization Strategy*, based on application of standardized approach towards particular segments of the world market on which the company operates with only minor changes in products, services, policies and procedures.

The choice of strategy is determined by two major economic factors: the possible degree of standardization of the world market and the economies of scale for the product or service in question. The choice of one of these strategies is also based on the company's decision concerning the degree of core competences' centralization. This requires considering of opportunities for the coordination and management of administrative costs (Morrison, Ricks and Roth 1991).

On one hand, the strategy of the parent company can be focused on centralization of the basic functions in the head office, while delegating some authority to foreign subsidiaries. This approach requires accurate specification, what areas of responsibility need to be delegated to foreign subsidiaries.

On the other hand, the head office can distribute functional areas of responsibility between various countries in such a way that the competitive advantages of each subsidiary can be used in the most effective way. This approach involves the highest administrative costs. Moreover it requires a high level of complex integration mechanisms and also the sharing and supporting of the same organizational culture in all international divisions of a company.

The evolutionary approach to the study of international expansion strategies has been suggested by Birkinshaw and Hood (2001). According to this theory one can distinguish three stages of development of a company: paternalism, expansionism and liberalism. The paternalism stage (according to Birkinshaw and Hood this was typical for the first half of the twentieth century) presumes that a company innovates in the home country and then distributes new products and services to foreign subsidiaries. The expansionism stage presumes that innovation also occurs in selected foreign countries, but the task of identification and promotion of these innovations is assigned not to foreign subsidiaries, but rather to special "scanning units." Finally, the liberalism stage corresponds to the situation when valuable ideas can emerge anywhere in the world. The more distant is the subsidiary from the headquarters (HQ), the more their employees become less constrained by norms and belief structures of the parent company and thus more open to innovation.

## Forms of strategic control

Companies may implement strategic control through Corporate Centers (CC), which in different markets play different roles. There are many publications, describing and analyzing roles of CC. Most of them, however, do not cover cross-border aspects of control (Goold and Campbell 1987, Johnston and Gill 1993, Simons 1994).

We are basing our further study on the work of Nathaniel Foote, David Hensley, Max Landsberg and Roger Morrison (2003). In their paper "Role of the corporate center" authors have suggested a set of distinguished roles that CC may play in the international activity of companies. These roles constitute a certain continuum.

On one pole there is the "Financial holding" role. A "Financial holding" type company consists of a set of independent business units that have weak communications with the corporate center. In this model the functions of the corporate centre include first of all of the financial control through the tasks of budgeting and careful profit and cash flows management. The role of the CC also includes hiring, performance evaluation and firing unit managers. Thus a head office does not attempt to co-ordinate activity of business units or to attempt to create any synergism between units.

On the other pole we find so-called "Operator" who usually develops only one line of business, but has some profitable divisions that either work in different regions, or produce different goods. Between these poles there are "Strategic architect" and "Strategic controller". Corporate center as a "Strategic architect", realizes two basic functions. First, it generates the general strategy while business units have freedom for development of their own initiatives. Second, it monitors the subsidiaries businesses, periodically initiating discussions concerning general strategy of divisions. The head office as "Strategic controller" focuses on careful and often functional analysis of business units' strategy and undertakes more efforts in achieving a synergy effect.

The choice of form of strategic control is influenced by set of both internal and external factors. First of all, the company, making the decision on the form of strategic control, appreciates international strategy as a vector of foreign subsidiaries' development. There are also other significant factors, such as market structure, power distribution between players, and general industry dynamics. However it is necessary to consider cross-cultural issues as they influence control implementation directly. In practice, it is usually not easy to specify a company as one belonging to the certain type as combined forms are often used. Moreover, forms of strategic control differ across the set of subsidiaries. In order to diagnose the form of strategic control one needs to analyze a company's internal processes and especially the mechanisms of control used with respect to a company's subsidiaries.

## Mechanisms of strategic control

There are four different (although complementary) mechanisms by means of CC can assure that activities of different (included foreign) subsidiaries are in line with the strategy, targets, and standards of the mother company. These are: centralization of procedures (decision-making in the first place, but not only), formalization of procedures, output control and socialization of employees in different subsidiaries (Björkman, A., Piekkari, R. 2009).

Centralization means that certain processes are carried out exclusively at the parent company (in case of management — decisions are taken only at headquarters). This creates a number of advantages. First, CC may be sure that decisions and processes are in line with standards. Second, centralization may lead to higher efficiency of resources' utilization, as far as from the mathematical point of view, under conditions of perfect information any allocation of resources may be only equally efficient as centralized decision and never higher. Third, if there is a need to change the procedure in question, it may be done faster and cheaper. Fourth, centralization is an effective remedy against stealing resources, information drain and so on because it limits the number of employees involved. At the same time, centralization leads to longer decision-making cycles. It may lead to a lower quality of decisions due to the fact that not all information is available at CC and it is difficult, if ever possible, to take into account the entire specific circumstances of problem situations in each subsidiary. Centralization decreases the diversity of the company operations and thus makes it more vulnerable to certain risks.

Formalization stands for imposing of formal (written) rules, policies and procedures. Of course centralization may also be implemented through formalization (there is a document, stating that particular decisions have to be made by the CC exclusively). But there are numerous instances when the CC allows subsidiaries to make decisions by themselves but prescribe them how to act. So we have a distributed execution of standardized procedure. This creates the opportunity to take decisions faster and base them on more reliable information.

Output control means that subsidiaries are obliged to report certain numerical indicators to the CC. It differs from formalization also in the sense that while formalization attempts to control the process, output control concentrates on results. Generally speaking, subsidiaries are given more degrees of freedom. There is minimal need in training (what has to be reported and when, and what does it mean).

Finally, the CC may not want to decide everything, or to strictly prescribe how to act, or to control the results. Instead, it may attempt to encourage all employees to share the same goals, values and attitudes. This is in the long-run the most efficient way to assure the uniformity of operations across subsidiaries. It eliminates the need for strict control and extensive training not to speak about lengthy instruction manuals. Two-way information flows between HQ and subsidiaries are typical for this mechanism. But the reliability may vary and is always a problem. It is also time-consuming at the implementation phase: usually it is much easier and faster to issue another instruction rather than obtain changes in employees' behavior as a result of socialization. That is why it is usually combined with other mechanisms.

We have summarized different elements of international expansion strategy in Table 1.

**Table 1: Different Elements of Company International Strategy and its Implementation**

Types of international strategy	Stages of international operations development	Forms of strategic control	Mechanisms of strategic control

Multinational / Global	Expansionism / Liberalism / Paternalism	Financial holding Strategic architect Strategic controller Operator	Centralization Formalization Output control Socialization
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If a company chooses multinational strategy, most likely geographical expansion will have more features of liberalism, i.e. giving subsidiaries more freedom in decision-making. Consequently, a corporate center will play a role of “Financial holding” and strategic control will be carried out by certain indicators (output control). Otherwise, choosing globalization as company’s basic strategy, type of its international operations more likely will referred to as paternalism. In this case CC will act as “Strategic controller” or “Operator”, and operations will be centralized. Moreover, different aspects of subsidiaries’ activity may be controlled through various mechanisms. Certainly, there are cases when companies combine various strategies and forms of control to achieve competitive advantages through more flexibility on one hand, and alignment to internal processes on the other.

## METHODOLOGY

In our research we have used various methods of data analysis. A methodology of this research is based on the single case-analysis (Yin 1994). Specific research tools included structured in-depth interviews with top and middle management, based on 60-questions questionnaire covering various aspects of the company activity and study of company primary documents.

## COMPANY IN QUESTION

The object of this research is a multinational company (MNC), based in Finland and operating in some European countries including Russia. We have focused our research on the specific issue of strategic control of MNC’s Russian subsidiaries. The company has been working for 5 years on the Russian market through the set of subsidiaries registered under the Russian law. The company has significantly expanded its operation during this period. The MNC operates in a growing market sector which has not been impacted by cyclical effects. Even in the times of financial crisis the company has not does not stop its operations and even expects total profit growth, especially in Western Europe. The MNC operates on both the business to business (B2B) and business to government (B2G) markets. The main customers in Russian are business organizations and municipalities. One of the company’s clear advantages is its brand as an experienced, responsible and innovative expert in ecological services.

## RESEARCH FINDINGS

In order to characterize the cultural peculiarities of the two nations concerned, we have applied Hofstede’s (Hofstede, 1980) cultural dimensions approach. According to Hofstede’s research of culture characteristics Russia and Finland are described by the following indicators

**Table 2. Hofstede's Estimates for Finland and Russia**

	PDI	IDV	MAS	UAI
<b>Finland</b>	33	63	26	59
<b>Russia</b>	93	39	36	95

Source: [http://www.geert-hofstede.com/hofstede\\_dimensions.php](http://www.geert-hofstede.com/hofstede_dimensions.php)

where PDI - Power Distance Index, IDV – Individualism, MAS – Masculinity and UAI - Uncertainty Avoidance Index. Both national cultures demonstrate high levels of uncertainty avoidance (UAI). Russia has presumably higher level of power distance (PDI) and masculinity (MAS).

The Russian market may be described in the following terms. While in the US and Western Europe the interest of enterprises and organizations in environmental certification is high, as it is a tool for gaining leadership in markets, Russian companies do not have a significant stimulus to acquire environmental certification of their production systems. The environmental legislation in Russia differs substantially from that in EU countries. In Russia the business of environment protection is concentrated basically in big cities and there are different rules in each region.

In order to identify particular features of the company's market environment that influence control implementation we have used Porter's Five Forces Model (Porter 2008). This model appears the most relevant for our analysis as it covers the most significant factors of the business microenvironment.

*Consumers of service are basically municipalities.* Although the MNC has corporate clients, the largest share of services falls on municipal bodies, such as housing service companies and city authorities. This influences company business processes, in particular processes of external communication with representatives of authorities.

*Service quality significantly depends on subcontractors.* In Russia the network of subcontractors in this sector is poorly developed. Basically these are former state enterprises which were fragmented during privatization. At the same time the small business sector on which the MNC interacts with in Finland has not yet developed in Russia. Therefore the mechanisms of interaction with suppliers needed to be adapted to existing Russian conditions. The MNC is compelled to make internal hires of employees instead of outsourcing services, which has been the MNC's common practice in other foreign markets.

There are significant *entry barriers* for potential competitors since there are close relations and trust on between the municipalities' top administrators and the MNC. The main customers of the MNC are city government where it provides services. Therefore it is very difficult for a newcomer to enter this market and to compete with companies that have entered it earlier.

It is difficult to name any *substitute of providing services*. Environmental services are peculiar enough by their nature. Therefore it is difficult to find services which could be regarded as substitutes. At the same time, power of this market force is insignificant.

The main *competitors* are municipal organizations. The MNC faces competition from other organizations having close connections with city authorities, but so far it is superior in its quality of services provided.

The MNC has an extensive document management system (DMS) including procedures for making all essential decisions that indicates timeframes, decision-makers, their discretion and their responsibilities. The MNC faces the problem of transfer of the DMS, originally developed in Finland, to Russia. Every mechanism of the DMS taken alone has both advantages and disadvantages, thus suggesting reasonable combination of them. This constitutes the first foundation for the subsequent analysis of DMS: we attempt to attribute every component of the DMS as a manifestation of our research framework regarding centralization, formalization, output control or socialization.

As far as the document is organized in line with such areas of the MNC activities such as management, DMS itself, finance, human resources, purchasing, communications and customer relations, it provides the opportunity to understand the application of various mechanisms in various areas. We have found that the use of mechanisms was not proportional across these areas. Some of them were better centralized, other — better formalized and so on (see Table 3).

**Table 3. Mechanisms of Strategic Control, Used by MNC Across Areas**

Area of activity	Dominant subsidiary control mechanisms
General management	Centralization, Formalization (in part)
Risk management	Centralization
IMS maintenance	Centralization, Formalization (in part)
Internal audit	Centralization
Control of documentation and records	Formalization
Finance	Output control, Formalization
HR	Formalization
Purchasing	Formalization
Communication	Centralization
Sales	Centralization
Brand management	Centralization

## DISCUSSION AND CONCLUSION

One can clearly see from the table 3 that although formalization appears to be the very approach on which Finns and Russians are most prepared to agree and act together, it is definitely underused at the expense of centralization. This is not in line with the cultural peculiarities of the two nations. We have noted that in terms of CC-subsidiary relationships peculiarities of the Russian culture preclude lower tolerance to centralization but favors formalization. Output control appears to be underused as well.

High level of UAI means that in both countries employees have needs for rules and instructions. Thus there is a favorable outlook for the implementation of all types of formalization. At the same time, features of the Russian culture preclude Russian employees to focus on career development rather than quality of life to greater degree than their Finnish counterparts. Higher levels of remuneration are more important to Russians. Assertiveness is valued higher than intuition. Along with high PDI this means that an ideal manager is a kind of — “good father”, demanding, but caring. This implies high level of concentration of power in the hands of the subsidiaries’ CEOs. In terms of CC-subsidiary relationships it precludes lower tolerance to centralization.

The MNC operates Russian subsidiaries as its own internal divisions. But according to the Russian law the General Director of a Russian subsidiary possesses full sovereignty in his or her decisions. But according to the procedures adopted by the MNC the rights and responsibilities of the GD are considerably limited.

The general understanding from the series of interviews and documentation analysis is that the MNC is currently operating on the first stage of development in terms of geographical scope: the *paternalism stage*, at least with respect to Russian subsidiaries. In other terms, the MNC adheres to *globalization strategy* that means that the company adheres to centralization of its basic functions with certain account of local features, and also to distribution of elements of a value chain in various countries. This strategy requires coordination and integration of the overall value chain. If this requirement is realized successfully effective business processes can become a steady competitive advantage of the MNC. To keep the MNC’s strategy in line with its internal business-processes the CC likely plays a role of “*Strategic controller*”. The “strategic controller” is responsible for major investments, allocates resources, and coordinates subordinates to gain synergy.

This method of operation can be justified by the requirements of the initial phase of entering the Russian market. On the other hand, environmental services are characterized by strict legal requirements. Moreover the quality of service is difficult to determine. Consequently, a MNC which aspires to keep its reputation as reliable partner needs to supervise constantly both its own subsidiaries and external subcontractors. This provides additional justification for the choice of the globalization strategy.

The mechanism for decreasing administrative costs and transfer of resources and control over them was necessary for implementation of the MNC’s strategy, Therefore it is logical that the company aspires to document its internal processes to a greater degree. This is also in line with the role of the CC as “Strategic controller”. Nevertheless, in our opinion, some functions such as relations with municipalities (government relations) and marketing should be delegated to local managers as they understand the country and market specificity better than representatives of the head office (CC).

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