MANAGING THE MULTINATIONAL FIRM:  
A FRAMEWORK FOR DECISION MAKING

The Broad Dimensions

Managers of global companies make decisions across a range of firm and plant-level activities encompassing activities associated with traditional functions such as finance, marketing and production, as well as those associated with less traditional actions such as international business-government relations and international accounting. Although it is difficult to define a homogeneous set of management principles that harmonize the heterogeneous set of activities ongoing in a global organization, it is possible to identify several core and common concerns. In particular, two broad concerns arguably define the main dimensions within which multinational management decisions are made. These two dimensions have been identified and discussed in previous classes. They define tradeoffs with respect to two considerations: (1) to what extent should specific actions be standardized or differentiated across the product and geographic markets in which the firm participates? (2) to what extent should responsibility for specific actions be centralized within headquarters, either global or regional, or decentralized to smaller, international affiliates?

Standardization versus Differentiation

The meaning and relevance of “standardizing” business activities will depend, to a great extent, on the nature of the activity in question. The notion is, perhaps, most obvious in the case of marketing. Activities associated with the marketing function are described, for convenience, as the “Four Ps”: Product, Price, Promotion and Place. In the context of decisions surrounding product choice, complete standardization would involve designing a product that is identical in every relevant way for each geographical market in which the product will be sold. Clearly, absolute product standardization will rarely, if ever, be a viable marketing strategy for reasons that will be discussed in more detail in the marketing segment of the course. Conversely, complete differentiation would involve altering relevant features of the product in significant ways for each and every individual geographical market in which the product is sold. It seems clear that the costs of complete
differentiation will be prohibitive in the vast majority of cases. Thus, the broad goal of international marketing managers is to identify where and how specific changes in product features will be profitable.

Complete standardization of pricing would involve setting the exact same price (in currency-adjusted terms) in every geographical market in which the product is sold. Again, for numerous reasons that will be discussed in the marketing segment, price standardization is unlikely to be financially advantageous to the firm. It may even be legally impossible. On the other hand, charging a different price in every individual geographical market is likely to prove impractical, or overwhelmingly inefficient, in the vast majority of cases. As a practical matter, therefore, international marketing managers must identify whether it pays to charge an above or below-average price in a specific market (compared to the average price charged across markets), and, if so, how much higher or lower that price should be.

Product promotion encompasses a range of activities associated with making consumers in different countries aware of the organization’s products, as well as encouraging consumers to buy the product rather than rival offerings, typically through advertising. Place is a pneumonic that represents decisions concerning how to distribute the product(s) in international markets. Again, in theory, firms can promote and distribute products exactly the same way in every individual foreign market in which they do business. Alternatively, they can customize their promotion and distribution initiatives for each specific foreign market in which they do business. As a practical matter, neither extreme solution is likely to be profitable. Effective global marketing will involve identifying and implementing a “mixed” or “interior” set of strategies, i.e. some degree of differentiation that falls short of complete differentiation.

The primary focus of the marketing segment is, therefore, to identify and discuss the factors that influence the benefits and costs of standardizing specific marketing activities. While these factors cannot be reduced to a convenient quantitative equation, their identification can assist marketing managers to understand better when the benefits of more, rather than less, standardization are likely to exceed the associated costs and vice-versa. Identification of these relevant factors should also provide a basis for evaluating, qualitatively, if not quantitatively, the relevant benefits and costs of increased
versus decreased standardization. The marketing segment should also help international marketing managers understand how to differentiate specific marketing initiatives. For example, how can different prices be maintained in different geographical markets, especially if those markets are relatively close to each other in terms of distance?

Centralization versus Decentralization

The nature of the centralization-decentralization dimension can also be best illustrated by reference to marketing activities. Consider the product design activity. At one extreme, decisions about product design might be the responsibility of marketing managers located at a specific affiliate—usually the “parent company”. The product features chosen by headquarters, in turn, determine the product features that will be offered by all other affiliates within the global company. At the other extreme, responsibility for choices regarding product design might devolve to managers located in each individual affiliate.

As in the case of the standardization-differentiation tradeoff, an “interior” solution is likely to be the preferable one rather than an extreme solution such as complete decentralization. That is, some degree of decentralization is likely to prove most effective. In this context, a number of important, practical issues must be addressed in attempting to “partially decentralize” decisions about product features. Perhaps the most fundamental overarching issue is how headquarters’ managers and managers at individual affiliates share information and make concessions in order to produce the portfolio of products that will be sold by the global organization. Although somewhat stylized, it is not overly simplistic to assert that headquarters will usually prefer more standardized features, whereas individual affiliates will generally demand significant differentiation. Partial decentralization of decision-making, therefore, invites greater management pressures for differentiation. The goal of the global organization is to ensure that the benefits and costs of greater product differentiation be clearly identified and understood by all marketing managers in the global organization, and that whatever group of managers ultimately makes product design decisions, those decisions are consistent with the identified benefits and costs.
Hence, the issue of how much to decentralize decision-making with respect to product design is inextricably linked to issues surrounding how to organize the company so managers are well informed, share a common purpose, and have channels within the company to make their case for specific product features. In principle, if all managers are equally well informed and equally motivated by shared organizational goals, it probably wouldn’t much matter where in the global organization decisions about product features were made. In practice, some managers may be better informed than others about the benefits and costs of alternative product designs. For example, for consumer non-durable products such as specific clothing items, market demand across regions might be relatively heterogeneous and also relatively changeable on short notice. As a result, local and regional marketing managers may be better informed than their counterparts at headquarters regarding what product designs are likely to sell well in their regions and what designs will fail. All else constant, there should presumably be greater decentralization of decision-making responsibility in the case of a global company in the clothing industry than, say, in the case of a global company in the oil industry where products are relatively homogeneous from market to market. Of course, the global clothing company must be organized such that local and regional managers are held responsible for their decisions, and so they act with the interests of the global company in mind. We shall have much more to say about organizing the global company in a later section.

The degree to which decisions regarding pricing, promotion and place should ideally be decentralized follows much the same logic as in the case of the product design activity. That is, some degree of decentralization is undoubtedly preferable to complete centralization or complete decentralization. Moreover, an economically sensible and commercially effective decentralization strategy will be sensitive to the nature of the product(s) in question, the geographical regions in which the organization operates, and the ability of the organization to structure itself in a manner appropriate to the decentralization strategy to be implemented. The general principle, as noted above, that more heterogeneous markets demand greater decentralization, holds in the context of all marketing decisions. However, this principle must be qualified by another equally relevant principle. Namely, headquarters should be cautious about devolving decision-
making to regional and local managers as marketing decisions become more interdependent across the organization. Equivalently, headquarters’ management should more closely monitor the decisions taken by regional managers as regional and local affiliates become more interdependent.

The preceding point can be illustrated in the context of promotion-specifically advertising. Differences in cultural and legal institutions often mean that advertisements for one geographical market are ineffective, or inappropriate, for other geographical markets, even after allowing for careful language translations. As an example, advertisements that emphasize luxuriousness and exclusivity as features of a product may be less effective in the more egalitarian societies of Scandinavia than in the less egalitarian societies of the United States and Canada.

In principle, advertisements could be designed by local marketing managers to match local market features, including idiosyncratic social attitudes. In practice, this could prove to be prohibitively expensive. Perhaps of more concern, to the extent that advertising “spills across” geographical boundaries, advertisements that convey different messages for different groups of customers may lead to the loss of a clear brand identity everywhere. For example, the Range Rover vehicle might be advertised as a “luxury” SUV in some markets, and as a “workhorse” off-road vehicle in others. If large groups of consumers see the different advertisements, they may well question whether either of the claims is “valid.” With the spread of advertising on satellite television channels, the Internet and even in feature films distributed worldwide, cross-border advertising “spillovers” are arguably becoming an increasingly important feature of life. These developments are augmented by the continued growth in international tourist travel. As a consequence, the advertising carried out by any individual affiliate is increasingly influencing the effectiveness of advertising carried out by other global affiliates within organizations. The more important such spillovers are, the less advantageous it will be to decentralize responsibility for advertising, other things the same. At the least, the existence of spillovers enhances the importance of headquarters’ monitoring and control of the advertising decisions taken by regional and local managers.
Independence of the Dimensions

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At this point, the reader might well ask the question: how independent are the two conceptual dimensions of global management described above? Specifically, does “standardization” necessarily imply “centralization” of decision-making? Alternatively, does “differentiation” necessarily imply “decentralization”? Quick reflection might suggest so. Certainly, to the extent that a specific business activity will be undertaken exactly the same way everywhere, there are limited benefits to deleting responsibility for making the relevant decisions to regional and local managers. Rather, headquarters’ management should presumably inform regional and local managers of the way in which the activity is to be carried out and provide appropriate incentives to solicit the responses that it wants from affiliates. However, as indicated in our earlier discussion, complete standardization is rarely an appropriate strategy.

Given that most strategic choices will involve some degree of differentiation, it seems plausible that there will be some associated decentralization of decision-making. However, there is nothing like a rigid relationship between the two. For example, factors influencing demand for a product may vary widely across geographical markets. Nevertheless, headquarters management may be reluctant to delegate the responsibility for setting prices to managers in foreign affiliates. For example, headquarters might be
concerned about “gray markets” emerging in which resellers buy the company’s product in relatively low-priced markets for resale in relatively high-priced markets. Were this to happen, it might jeopardize the economic survival of preferred distributors of the company’s product in the high-priced markets, as consumers increasingly buy the product from the resellers. While specific local managers might strongly prefer to set relatively low prices in order to compete effectively in their geographical markets, they may well ignore the potential for their low prices to disrupt marketing activities ongoing in other geographical regions. As a consequence, prices set by headquarters are likely to show less regional variation than prices set on an affiliate-by-affiliate basis.

Note that centralization of the pricing decision does not mean that headquarters’ managers should ignore regional differences in demand conditions or ignore the advice of regional managers. It would be foolhardy for management at headquarters to ignore valuable insights that are more reliably captured by managers closer to the relevant geographical markets. Nor does it mean that management should impose a relatively standardized worldwide pricing schedule for its products. Rather, the inference one should draw is that even relatively differentiated prices should be determined by a relatively centralized decision-making process when prices charged to specific groups of customers can strongly condition the prices that can be charged other groups of consumers. Put in other words, more centralized decision-making is likely to be preferable, even in the presence of highly differentiated strategies, if individual affiliates are relatively interdependent with respect to the management action in question.

**Generic Factors Involved in Standardization and Centralization Decisions**

Another question the reader may pose at this point is: what are the factors involved in the centralization and standardization decisions? As with the previous question of independence of the two dimensions, there is some overlap among factors involved in the decision process for each dimension. That is, some factors are important in both the standardization decision and the centralization decision. However, each set of factors should be discussed in its own right.
Concerning standardization, a very important factor in the decision is whether economies of scale can be gained in activities by standardizing either products or processes across the organization. If they can, the economic argument typically will be in favor of standardization, and accordingly headquarters managers will feel pressure to standardize those products or processes. Using the marketing example from above, if economies of scale can be gained through standardization of the firm’s product line, managers will face a fairly compelling argument in favor of standardization in that per-unit costs of production will be reduced. Another factor that, if present, will lead to pressures to standardization is the degree of interdependence present in the relevant parts of the organization. As noted above, if differential pricing might lead to gray-market possibilities, then managers will feel pressure to standardize pricing to eliminate those possibilities.

Other factors may bring pressures on managers to differentiate products or processes, or in fact may limit the degree of standardization managers can implement. One of these factors concerns laws and regulations of the various geographic markets in which the firm participates. As laws and regulations in relevant areas differ across borders, standardization becomes less possible. In the marketing example above, the degree to which standardization of price is possible can be limited by laws or regulations that vary across the firm’s geographic markets. Barriers to entry form another factor that limits standardization possibilities. Economies of scale may not be possible if tariff or non-tariff barriers exist in a market, for example, even if the barriers are not so great as to make the market unattractive. A third factor limiting the degree of standardization that is

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possible is the difference in technology in different markets. Differences in the degree of Internet penetration, driven by differences in the availability of advanced communication networks, may affect the degree to which standardization of promotion activities can be accomplished. Finally, cultural and economic differences across markets, although not necessarily imposing limits on the possibilities of standardization, may exert pressure to differentiate the product or process. Again thinking of promotion activities, advertising that works in one market may offend in another due to cultural differences. Along similar lines, real income differences across countries may contribute to different tastes and preferences, especially for consumer goods.

Some factors important to the standardization decision reappear in the list of factors important to the centralization decision. For example, interdependence among markets plays the same role in both decisions. Regarding centralization, as discussed in the marketing example, increasing interdependence should lead to increasingly centralized decision making, to ensure that the welfare of the entire organization is being considered. Laws and regulations also play the same role in the centralization decision as in the standardization decision, in that differences in laws and regulations place a limit on the degree to which centralization can occur due to the expertise required for each market in which the firm operates.

Homogeneity of markets as a factor in the centralization decision is similar to, although not exactly the same as, cultural differences in the standardization decision. Homogeneity of markets refers not merely to cultural differences but also demographic and other differences in markets served by the firm. Increasing homogeneity allows more centralization of decisions; knowledge of the markets will more easily be located at headquarters if those markets are similar. If those markets are changing quickly, or at different rates, in any relevant area, however, all things being equal centralization becomes less desirable as decisions must be made quickly and knowledge may not transfer quickly enough in such a situation. This leads to the final, and perhaps most important, factor in the centralization decision: the degree to which information can be communicated easily and quickly from the geographic markets to headquarters. If information takes time to reach headquarters, it becomes much more difficult to track the rate of change of markets and the continued homogeneity of markets. Thus, headquarters
will feel pressure to devolve decisions onto the regional or country managers, who have the necessary information readily available. For example, if the tastes of one market change quickly but those of another market stay the same, decisions regarding product features are made at headquarters, and information about the market change is slow to arrive at headquarters, opportunities will be lost in the first market that could have been seized if decision making were located at the country level.

These factors’ importance in each of the functional areas of the organization will be the focus of much discussion in the class sessions concentrating on each functional area. In some cases only a few factors will be important; in others all factors will be important. This section was meant to provide you with a general guide to the factors and their generic effects on the centralization and standardization decisions.

Applications to Other Activities

In this section, we outline how the two broad dimensions of our conceptual framework can apply to other functions and activities in the organization besides marketing. Before doing so, we should note that future class discussions will elaborate extensively upon the ideas briefly touched upon here. Moreover, it must be acknowledged that not all specific activities associated with different global business functions can be neatly and completely evaluated within the standardization-differentiation and centralization-decentralization contexts. Nevertheless, we believe that the contexts are useful ways to integrate what might otherwise seem to be disparate and unrelated management issues. They also help keep management focused on what is arguably the main challenge facing the global firm; namely, how to leverage the benefits of economies of scale while making necessary adaptations in the way the firm operates in order to accommodate the heterogeneous environment in which it operates.

Government Relations

Relations with foreign governments and international non-governmental organizations (NGOs) are very important influences on the ability of multinational companies to carry on their global activities, including their ability to establish affiliates in foreign countries. Government relations encompass a heterogeneous set of activities
ultimately designed to create a favorable environment for the global organization to carry out its basic business activities. In very broad term, the set of relevant activities focuses on identifying and understanding the priorities of national governments and the main constituencies that participate in the public policy process in countries of interest to the global firm, as well as creating a favorable business environment for the firm. The latter usually obliges the global firm to demonstrate that the firm’s activities in a country are beneficial to host country residents, especially in light of host government priorities.

Government relations are much more complex than simply lobbying politicians for lower taxes, favorable regulations and the like. They also involve complex negotiations and dialogue with both government and non-government leaders. In this context, it might seem that the relevant activities would be most effectively carried out if they were decentralized to managers and staff of local affiliates. As Mahini and Wells note, the subsidiary manager is likely to be most intimately familiar with the local environment, and therefore better able than home country managers to identify arising issues relatively quickly, as well as the likely decisions that the host government will make with respect to the issues. The subsidiary manager is also more likely to have personal contacts in government that may allow the global firm to make its position on public policy issues more effectively known to government. Furthermore, the subsidiary manager arguably has stronger incentives than home country managers to act effectively, since his or her success is more directly related to policies implemented by the host government.

If the impacts of a firm’s relations with individual foreign governments were restricted to the individual countries in question, decentralization of managerial decision-making for the government relations function would make compelling good sense. However, matters are usually not that simple. In particular, the actions of one government can affect other parts of the global firm in a number of ways. That is, there is usually a mutual dependence among the foreign affiliates of a global firm with respect to public policy. We shall discuss the potential nature of this interdependence in a later section. Suffice to say at this point that the existence of such interdependence creates a need for management to take into account the global implications of government relations activities across many or all of the firm’s affiliates. This need, in turn, generates pressure
for top management to vest authority for government relations in a level of the organization higher than that of the individual subsidiary manager. In addition, centralization of the government relations function facilitates the hiring of specialized personnel, such as international lawyers, to assist in the function, since the costs of specialized personnel can be spread over all of the countries in which the global firm operates.

The inference that can be drawn is that the global firm ordinarily needs to implement some degree of decentralization stopping short of providing complete autonomy to affiliate managers. Put differently, managerial responsibility must be assigned in a way that interdependence among affiliates is clearly recognized and acted upon. One broad vehicle for doing so is to create formal or informal committees made up of managers from local affiliates as well as headquarters. The committees, in turn, serve as vehicles for exchanging information about the policy environment in different countries and how decisions in one country may affect the firm’s operations in other countries. Such committees represent one of several possible “hybrid” approaches to achieving “incomplete” centralization or decentralization in activities where incomplete commitment to one or the other is undesirable.

Some concerns about global firms tend to be shared by many, if not all, national governments. For example, virtually all governments want multinational companies operating within their political jurisdiction to pay “appropriate” taxes. In many cases, such a uniformity of concern facilitates the adoption of a relatively standardized corporate position on the issue of appropriate taxation. In other cases, a particular position on a specific issue might be non-negotiable, because deviation from the position might compromise the very existence of the global firm. For example, a firm might be unwilling to make proprietary technology available to local firms in order to protect that technology. Or a global firm might insist on the ownership of businesses that utilize its global brand name or trademark in order to protect the integrity of those assets. In such cases, a uniform or standardized set of corporate policies would presumably make sense wherever the global firm does business.

In other cases, policy issues may be idiosyncratic to specific countries or groups of countries. For example, concerns about “sweatshop” working conditions are irrelevant
for the affiliates of global companies that operate in developed countries, although they are potentially quite relevant for affiliates in Southeast Asia and China. As such, corporate responses to political concerns about working conditions will be relevant for some affiliate managers but not others. In such cases, a “corporate position” on the issue of employee working conditions might not make sense. Furthermore, appropriate policies to address concerns about inhumane treatment of workers may vary even among developed countries. In some countries, governments may be taking the lead in establishing laws and regulations that govern labor market practices. In those cases, affiliate managers might best participate by making known to government officials the firm’s position on labor market practices and ensuring that the affiliate operates in a way that is consistent with both the spirit and the letter of the legal and regulatory environment. In other countries, there may be no official or even unofficial government position on workplace practices. In such cases, affiliate managers may find themselves dealing more directly with non-governmental social agencies to identify and implement “acceptable” labor market practices. In short, a differentiated strategy to deal with public policy concerns about labor market practices is likely to make sense.

In short, it is difficult to generalize about the degree to which global firms will find it optimal to adopt a standardized set of policies to deal with political issues affecting them. The goal of management should presumably be to identify and assess the benefits and costs of standardizing its policy response and choose standardization when the net benefits of doing so exceed the net benefits of a differentiated response. In practice, the net benefits of standardizing versus differentiating are likely to vary by issue and are also likely to be very difficult to quantify with any precision. However, the underlying sources of benefits and costs are relatively homogeneous, and a good understanding of those sources can assist in arriving at qualitative, if not quantitative, assessments of whether standardization is preferable to differentiation.

Production and Logistics

McGrath and Hoole (1992) identify five “basic” activities associated with production. The first, product development, is concerned with designing products. The second, purchasing, encompasses the acquisition on raw materials and intermediary
inputs used in producing the final product. The third, production, involves the actual manufacturing of parts and components and the assembly of those components into final products. The fourth, demand management, is concerned with using marketing and sales forecasts to set sales quotas, plan production schedules and inventory requirements, negotiate supplier contracts, and establish corporate revenue plans. The fifth, order fulfillment, focuses on the actual delivery of the final product to customers.

Within each of these broad activities is a set of numerous and more specific activities that must be carried out. For example, product development usually includes underlying research and development efforts, product engineering and safety testing, cost analysis and vetting of technical standards. Therefore, issues of centralization versus decentralization and standardization versus differentiation can be considered for more or less disaggregated product development functions. For convenience and economy, our consideration will be carried-out using the categorization of production described by McGrath and Hoole. We note that although McGrath and Hoole’s analysis is primarily directed at companies engaged in manufacturing, there is little in their discussion that cannot be conceptually applied to service sector companies, as well.

Standardization of product development is relatively easy to conceptualize as a concept. In the limit, it would involve designing and developing an identical product for sale anywhere in the world. A variety of considerations are likely to mitigate against the profitability of this strategy including potentially large regional differences in the tastes and preferences of potential buyers. Laws and regulations related to technical and safety features may oblige global firms to make design variations in order to be able to sell their products in specific locations. The critical issue in product, as in virtually all of the functional and corporate activities we shall discuss, is the optimal extent of “non-standardization”.

Standardization of purchasing would conceptually involve buying the identical inputs and components, presumably from the exact same suppliers, no matter where in the world those inputs and components were utilized. As we shall discuss in a later section, there are relatively large economies of scale in buying standardized inputs from a relatively small number of buyers. However, the ability to use standardized inputs and components usually obliges the global firm to employ relatively homogeneous production
methods in its different affiliates which may impose certain cost disadvantages on the global organization.

Standardization of production is a bit more difficult to conceptualize than the preceding two activities. It might be thought of as using identical production establishments and techniques to produce a product everywhere that product is produced. For example, the various production establishments would be of exactly the same size, use identical types of machinery and equipment, employ identical ratios of machines to workers and so forth. It is certainly unlikely that this type of arrangement would prove to be economical. In particular, there are relatively large differences across countries and regions in the relative cost of machinery and equipment versus labor versus land. Hence, a plant that is relatively intensive in its use of machinery and equipment might be relatively low cost in one location and relatively high cost in another. Moreover, employing modern technology in production establishments ordinarily requires the use of skilled and educated labor as a complementary input. The latter may be quite scarce in certain developing countries, making the use of modern technology problematical in those regions.

On the surface, it would seem much less problematic for global firms to use identical demand management techniques throughout their organization. For example, relatively standardized software programs exist that integrate demand forecasts and production scheduling and inventory management, although the technical ability to utilize computerized management information systems may vary across affiliates. Certainly, the use of highly dissimilar demand management techniques throughout the global organization would likely destroy the ability of the global organization to operate efficiently, especially with respect to the use of techniques such as just-in-time shipments.

As with other production-related activities, order fulfillment encompasses a number of more specific “sub-activities”. The latter include important functions such as warehousing finished products, and transporting products from warehouses to customers. At the extreme, standardization would presumably involve the identical configuration and operation of warehouses wherever they are located, as well as the use of identical transportation modes wherever the company’s products are distributed. In practice, global
firms do not completely standardize order fulfillment activities for reasons that, in many cases, are quite obvious. For example, the use of container ships requires access to deep-water ports. Many regions of the world do not have the capacity to service container ships. Hence, other modes of transportation must be used to bring goods into and out of those countries. On the other hand, there are well-known economies of scale associated with operating relatively standardized warehousing systems and with using the same shipper(s) for all transportation activities. Logistics managers must balance the costs and benefits of different degrees of standardization of the order fulfillment function.

Accounting

In broad terms, accounting is concerned with the generation and reporting of financial and operating information for the benefit of the firms’ managers, creditors, shareholders and other constituency groups. A traditional distinction is made between financial accounting and managerial accounting. The former is concerned with maintaining and reporting information for the public concerning the firm’s current and prospective financial condition. In this context, it encompasses, among other things, regular dissemination of information about the firm’s revenues and expenditures, as well as its assets, liabilities, and capital position. The latter is primarily concerned with maintaining and reporting information for internal management concerning aspects of the firm’s operational activities, such as the profitability of individual products, the inventory turnover of individual products, capital and operating budgets, and so forth. Although there is no clear dividing line between financial and managerial accounting, a rough distinction is that financial accounting is targeted for “public” audiences, while managerial accounting is targeted for “private” audiences within the firm.

In the case of accounting activities, legal and regulatory practices strongly condition both what is expected by way of financial reporting, as well as which corporate entities are expected to produce and disseminate accounting information. Clearly, all business organizations that are subject to taxation must submit regular tax statements to the jurisdictions in which they are subject to taxes. As well, all organizations that have public shareholders must regularly file a variety of financial statements to the appropriate regulators of the securities exchanges on which their corporate securities are traded. In
effect, these constraints imply that complete centralization of accounting activities is unfeasible. Individual affiliates of multinational companies must ordinarily produce and report financial information for host government and regulatory agencies. While this information could conceptually all be produced in a single location, financial reporting requirements and generally accepted practices differ across countries and regions. As a consequence, there may be few, if any, cost savings in pooling all of the global firm’s accounting activities in a single affiliate. Indeed, requirements to employ local auditing firms and the like may make such centralization impossible in the case of public accounting activities. More legal leeway presumably exists for centralized accounting with respect to private information. However, as a practical matter, local managers are in the best position to determine precisely what type of information is of most use to them, as well as when the information is of greatest value. Hence, decentralization of managerial accounting activities is common practice in global firms.

Nevertheless, some centralization of accounting is required so headquarters management can monitor and guide the activities of affiliate managers in the best interests of the overall global organization. Also, multinational companies must consolidate the accounting information produced in individual affiliates for purposes of financial reporting in their home countries. So while some aspects of accounting are likely to be highly decentralized, others will be centralized, although legal and regulatory considerations will have a strong influence on what specific activities will be either decentralized or centralized.

The fact that global firms usually confront country or region-specific accounting requirements implies that standardized accounting is impractical. For example, the Securities and Exchange Commission in the United States is generally considered to have more “demanding” accounting standards than comparable securities regulators in most other countries. As a result, global firms whose securities trade on U.S. securities exchanges must file greater volumes of more detailed financial information than do firms whose securities do not trade on U.S. securities exchanges. On the other hand, accounting boards and regulators have been making efforts, in recent years, to “harmonize” accounting practices across national jurisdictions so that companies are able to produce and disseminate relatively uniform financial information. As a general statement, the
direction is to require companies to disclose more information to the public, so that the harmonization process is presumably a convergence towards “stronger” rather than “weaker” disclosure requirements.

A broader issue is whether it is to the advantage of a global firm to standardize its accounting activities beyond the requirements imposed by regulators and accounting standards boards. To the extent that investors and other interested parties desire the same types of information to be disclosed, there will clearly be economies in standardizing many accounting activities. On the other hand, if different constituencies have differing information needs, standardized accounting practices may be very unsatisfactory, and global firms that do standardize their accounting practices may find it more difficult to raise financial capital, among other penalties. In the section dealing with accounting in the global firm, we will discuss more extensively the tradeoffs associated with standardizing accounting activities, as well as evidence bearing upon the benefits and costs of doing so.

Finance

A wide range of activities is encompassed within corporate finance departments. In broad terms, financial managers are concerned with the following activities: 1. acquiring financial capital at the lowest possible cost to support the company’s growth; 2. evaluating capital investment opportunities, as well as the profitability of maintaining existing assets (i.e. capital budgeting and analysis); 3. managing short-term assets, including cash, in order to ensure the firm’s liquidity, as well as earn an “appropriate” rate of return on those assets; 4. controlling risk such that the firm does not suffer large losses that, in turn, threaten its financial viability.

Raising Capital

Firms can seek financing from a number of sources. Specifically, they can use internally generated funds, borrow or issue equity. Management’s goal is to acquire the necessary funds at lowest possible cost. In this context, the issue of centralization versus decentralization is probably of greatest relevance. To the extent that each affiliate of a global firm is charged with responsibility for raising its own capital, the financial
managers of each affiliate may or may not choose identical sources of financing depending upon whether the relative costs of different sources of capital are identical in all countries. For example, in some countries, highly liquid and well-managed securities markets may make it relatively easy to issue debt and equity securities to public investors, thereby alleviating the need for firms to finance activities through internally generated cash flow. In other countries, opportunities to raise funds from private or public investors may be quite limited, thereby obliging firms to rely upon internally generated funds. In this case, it would not be cost-effective for the different affiliates to utilize identical sources on financing in the same proportions. That is, standardized financing would not make economic sense. On the other hand, if capital market conditions are relatively similar across countries, individual affiliates might well choose similar compositions of capital financing.

The basic determinants discussed earlier apply as well to the centralization-decentralization tradeoff in the context of capitalizing the global firm. In particular, if there are significant economies of scale in raising capital on securities exchanges, there is a potential argument for centralizing the financing activity in a single affiliate and having that affiliate raise funds for the global organization through large public issuance of debt and/or equity. As well, if financing activities of individual affiliates affect the ability of other affiliates to raise money, some coordination of the capital financing of affiliates is advisable. On the other side, considerations of risk management may dictate that local sources of financing be substantially utilized. In particular, the use of local sources of debt and equity might reduce the possibility of direct or indirect expropriation of the local affiliates’ assets by host governments, since expropriation would presumably be opposed by creditors and investors in host economies who have financial interests in the foreign affiliate.

Capital Budgeting

In a centralized capital budgeting environment, decisions about capital investments would be undertaken by a single set of managers in the global firm, regardless of which individual affiliates were actually going to utilize the relevant capital assets. Conversely, in a decentralized capital budgeting system, investment decisions
would be the responsibility of the managers of individual affiliates. Obviously, to the extent that investments made by an individual affiliate affect the profitability of other affiliates of the global firm, it would not make sense to completely decentralize capital budgeting decisions. Since the essential feature of a global firm is interdependence among affiliates owing to specialization of value chain activities across affiliates, complete decentralization would make little sense. On the other hand, local managers are often in the best position to identify and assess investment opportunities in their country or region, and the investment environments may well differ across countries and regions. Hence, some degree of decentralized capital budgeting activity is usually desirable. The goal in this case, as in most other activities, is to identify the appropriate degree of decentralization, as well as the organizational arrangements that will facilitate achieving the desired mix of centralized and decentralized decision making.

A standardized approach to capital budgeting would basically involve utilizing the same decision-making model in all investment decisions wherever they are made in the global firm. For example, managers might be expected to use a net present value model with an identical cost-of-capital estimate employed to discount future revenues and costs. The cost-of-capital estimate in this case would presumably be an estimate of the global firm’s overall cost-of-capital rather than the costs of capital of individual affiliates. On the other hand, a differentiated approach to capital budgeting would allow individual decision-makers to utilize decision criteria of their own choosing. For example, some managers might prefer to use a payback period investment criterion rather than net present value. More often, differentiated capital budgeting results in the use of different “hurdle rates”, or different estimated costs of capital by individual affiliates.

To the extent that coordination of capital budgeting decisions makes sense in the global firm, some degree of standardization is presumably needed in order to compare capital budgets across affiliates. However, to the extent that alternative capital investment opportunities are highly heterogeneous, a single approach to evaluating those investments will probably not make sense. For example, the outcomes of investment opportunities in specific developing countries may depend upon political events that are difficult to foresee with certainty. In such cases, attempts to quantify expected rates-of-return or net present values of the investments with any precision would be farcical. Evaluation
techniques that rely upon sensitivity analysis and subjective scenario-drawings might make a lot more sense than quantitative and precise numerical estimates of expected discounted net cash flows in such circumstances.

Managing Short-Term Assets

Short-term assets primarily include cash, accounts receivables, investments of less than one year’s maturity and inventory. Centralized management of the global firm’s short-term assets would effectively involve a single set of managers selecting both the level and composition of the short-term assets held by each individual affiliate. There are two broad goals of asset management. One is to ensure that all affiliates have sufficient liquidity to pay their bills and operate efficiently. The other is to earn a satisfactory rate of return on assets held by the global firm’s affiliates. The presence of economies of scale in this activity would promote centralized decision making, all other things constant. However, in the case of asset management, it is reasonable to think that individual affiliate managers will have a much better understanding of their own liquidity needs and short-term investment opportunities than will any single group of managers, usually located at the firm’s head office. The ability to utilize superior information, especially when the operating environments of individual affiliates differ markedly, mitigates in favor of decentralizing asset management activities.

As with most other financial activities, complete decentralization is objectionable, since completely independent management decisions are bound to be sub-optimal. For example, a number of individual affiliates may have excess cash balances to invest for a period of time. If one affiliate has substantial better opportunities to invest in short-term assets than the other affiliates, it makes sense to pool the cash balances across affiliates and allow the advantaged affiliate to invest those balances for the short-run. However, without some degree of intra-firm coordination, effective pooling of cash balances for reinvestment might not be achievable.

As in the case of capital budgeting, one can think of standardization of asset management as employing the same techniques and criteria to manage short-term assets wherever such activities are undertaken. Certainly, it would be unlikely that a single mix of assets would be optimal for every individual affiliate. For example, in countries where
transportation and warehousing facilities are relatively primitive, affiliates would presumably need to carry relatively large inventories of parts, components and semi-finished and finished goods compared to affiliates in countries with modern logistical infrastructures. As another example, in countries with relatively liquid markets for short-term assets such as treasury bills and commercial paper, affiliates are able to operate safely with relatively low cash balances, since interest-bearing assets can be converted into cash relatively quickly without requiring large price discounts. On the other hand, differences in operating conditions do not preclude affiliates using similar criteria and procedures for identifying future cash flow and inventory needs, as well as for evaluating the risk-return profiles of alternative short-term investment opportunities.

Risk Management

In the context of international business, the risks associated with fluctuating currency values are ordinarily more pronounced and complex than in the case of a company whose business activities are geographically specialized to a single country or currency region (such as the Eurocurrency group of countries). As a consequence, identifying and managing foreign exchange risks are ubiquitous activities in global firms. As we shall discuss in a later section, the activities of individual foreign affiliates are highly interdependent in terms of the foreign exchange risks those activities create. As a result, global firms ordinarily centralize, to a substantial extent, the assessment and management of foreign exchange risk, at least in terms of determining whether and to what extent hedging procedures should be implemented to reduce perceived foreign exchange risks.

On the other hand, the implementation of specific hedging activities may be best carried out by individual affiliate managers, especially if specific techniques for hedging make more economic sense in certain countries rather than others. There are ordinarily some transactions cost savings associated with hedging larger foreign exchange positions that, in turn, argue for standardizing the hedging procedures used across the global firm, other things equal. For example, financial intermediaries are usually uninterested in writing forward contracts involving relatively small forward market currency positions, and firms seeking to hedge relatively small foreign currency positions usually must make
use of higher cost hedging alternatives. However, in some cases, unique hedging opportunities may exist that individual local managers are in position to utilize. Hence, some degree of differentiation in hedging tactics may be desirable.

Another source of risk that tends to be much more relevant in the case of global firms is political risk. The latter relates to the consequences of foreign government actions that can financially harm the global firm. Although home country governments can, and do, implement policies that reduce the profitability of domestically owned companies, the viewpoint of many observers is that foreign-owned firms are more prone to punitive government actions than are domestically owned firms. Such actions can include the seizure of company assets without compensation and the freezing of corporate bank accounts to prevent repatriation of profits from local affiliates of global firms.

Since political actions frequently reflect local economic and social conditions, affiliate managers are usually in the best position to identify and assess the associated political risks. However, local managers also have incentives to understate potential problem, since presenting a worrisome picture of potential political actions might lead to reductions in the affiliate’s capital budget. Hence, while decentralization of political risk assessment might be expected, substantial “independent” vetting of the assessments prepared by affiliate managers is good practice. At the same time, actions taken to mitigate political risk may be more effective if they are centralized. As noted in the section discussing government relations, it is often the case that different affiliates face similar political risks, since actions by governments are often taken against firms in the same industry, such as the mining sector. In this situation, headquarters’ management might be able to “play” different governments against one other to thwart adverse policies directed at its affiliates.

When the nature of potential political risk differs across countries and regions, the appropriate responses are also likely to differ. For example, if the relevant risk is the imposition of punitive income taxes, global firms might seek to source their profits in relatively low tax countries to the maximum extent legally possible. If the relevant risk is expropriation of assets, global firms might use more local debt and equity capital in funding their foreign operations. Thus, differentiated strategies to hedge political risk are often appropriate. The practical relevance of a differentiated strategy is also suggested by
the fact that home government-provided insurance against hostile actions by foreign governments is usually available only for certain groups of countries.

Human Resource Management

Five activities typically fall within the domain of human resource management: selection, training, development, and compensation of employees and managers, and labor relations. Although, obviously, firms need to select, train, develop, and compensate employees at all levels, most of our discussions of these activities will focus on human resource management of managers.

In international business, there are four categories of candidates for managerial positions. A manager can be from the firm’s home country, or from the country in which he or she will work (commonly called the host country), or from a third country (neither the home nor the host country). Alternatively, a manager can be “aspatial.” An aspatial manager is seen as having no actual cultural home base, but instead is personally knowledgeable about, and equally comfortable with, several different cultures. Children of diplomats, who often are posted to different countries over their diplomatic careers, are good examples of people who might become aspatial.

In selecting managers for assignments, standardization issues come to the fore. An extreme form of standardization would be to select, say, home country nationals for every open managerial position. Although possible, this approach (or its complements, the selection of host country nationals, third country nationals, or aspatials) would not allow the firm to take advantage of any real differences in markets in which the firm operates. It also would limit the organization’s flexibility in responding to changes in the product’s life cycle position that might leave certain types of manager in low demand and other types in high demand. However, the opposite extreme of complete differentiation of selection—basically that the firm approaches each selection decision as a new decision—also seems to make little sense in that it does not capture learning economies gained from previous selection experiences. Empirical evidence tends to point to some standardization, not of country of origin but of personal qualities, as leading to successful selection of managers in international business operations.
Training and development in the context of international business usually focuses on expatriate managers—by which is meant any manager who is moving into an assignment in a different culture from the one with which he or she is most familiar. One might question the effectiveness of any training program for expatriate managers, arguing that immersion into a culture before job responsibilities begin is the only method that allows the expatriate to be effective in the new position. Leaving that aside for the moment, the initial logic in this case might lead toward a relatively differentiated training strategy, with standardization occurring only across assignments to similar cultures. Complete differentiation would seem to include adjusting training for every individual based on the culture to which the individual is being assigned, the culture from which the individual is moving, and the particular position to which the individual is assigned. Again, this would seem to ignore possible learning economies; it might also place more emphasis on the person’s home culture than is warranted. Complete standardization also seems difficult unless the firm operates in limited markets, as cultures differ enough to make a standard training session less than helpful in giving expatriates what they need to succeed in the new culture. Development activities would seem to follow the same logic. Repatriation at the end of the assignment might be considered part of training and development, and empirical evidence has shown that individualized attention to the repatriated manager leads more often to successful outcomes than does a standard approach. This would seem to argue for a highly differentiated approach to repatriation.

Compensation of managers in the international firm—including not merely base salary, but also benefits and allowances)—is complicated by differences across countries in standards of living and taxation policy, as well as fluctuating exchange rates. Complete standardization of compensation would disregard these differences, although perhaps all expatriates would receive a fixed allowance. Complete standardization seemingly goes against logic, although one could argue that assignments in countries with lower standards of living might be less attractive in some ways (limited infrastructure development, fewer amenities, high taxation, and so forth) which compensates for the lower cost of living in developing countries. If this argument holds, however, perhaps a better way to address the compensation issue would be to examine each individual situation and give make appropriate adjustments that explicitly account for physical and
psychological hardships. Exchange rate changes may require adjustments to compensation over time, especially in the case of substantial changes in currency valuation. Again, adjustments reflecting individual currency changes seem appropriate.

Labor relations in a global firm can cover many things, as the ability of employees to organize and bargain collectively will differ from one country to another, as will the legal and practical power any collective bargaining unit enjoys. Once more, that logic would seem to dictate that a completely standardized approach to handling labor relations will not be effective. Also, the ability to address specific labor issues in a specific country—say, alleged sweatshop conditions in China—will typically serve the organization well, not only in effectiveness, but also in the inevitable public relations battles that follow such allegations. Thus, a more differentiated approach seems called for in this actuality as well.

To summarize, in most areas of human resource management complete standardization ignores the nuances of differences across people and markets. Complete differentiation ignores the efficiencies that learning economies can bring to this management area. A fairly substantial amount of differentiation seems to be the logical generic prescription, always with the caveat that each situation will need to be examined. This conclusion might also seem to point to decentralization of human resource management activities, but such a conclusion does not naturally follow. For example, for important management positions in affiliates, headquarters management will need to make the assignments, so a centralized approach at higher levels of management hiring seems called for. At lower levels the differentiation necessary across markets may indeed lead to decentralization of authority in selection and compensation, although some training and development aspects may still be centralized to ensure consistency of approach throughout the organization.