

PART II

CONTROLLING OF INTERNATIONAL BUSINESS

There are three main levels at which control can be implemented and managed in an international business. These three key levels of control are as follows:

Strategic

Organizational

Operational

Strategic Control:

Strategic control is intended both how well an international business formulates strategy and how well it goes about implementing it. Thus strategic control focuses on how well the firm defines and maintains its desired strategic alignment with its environment and how effectively it is setting and achieving its strategic goals.

Strategic control also plays a major role in the decisions firms make about foreign-market entry and expansion and most critical aspect of strategic control is control of an international firm's financial resources.

Organizational Control:

Organizational control focuses on the design of the organization itself. There are many different forms of organizational design an international firm can use. But selecting and implementing a particular design does not necessarily end the organization design process.

International firms generally use one or more of three types of organizational control systems:

i. Responsibility Centre Control:

The most common type of organizational control system is a decentralized one called responsibility centre control. Using this system, a firm first identifies fundamental responsibility centers within the organization. Strategic business units are frequently defined as responsibility centers, as are geographical regions or product groups.

ii. Generic Organizational Control:

A firm may prefer to use generic organizational across its entire organization; that is, the control systems used are the same for each unit or operation, and the locus of authority generally resides at the firm's headquarters.

iii. Planning Process Control:

A third type of organizational control, which could be used in combination with either responsibility center control or generic organizational control, focuses on the strategic planning process itself rather than on outcomes. Planning process control calls for a firm to concentrate its organizational control system on the actual mechanics and processes it uses to develop strategic plans.

Operations Control:

The third level of control in an international firm is operations control. Operations control focuses specifically on operating processes and systems within both the firm and its subsidiaries and operating units. Thus a firm needs an operation control system within each business unit and within each country or market in which it operates.

Establishing International Control Systems

Control systems in international business are established through four basic steps:

Set Control standards for performance
Measure actual performance
Compare performance against standards
Respond to deviations

i. Set Control Standards for Performance

The first step in establishing an international control system is to define relevant control standards. A control standards in this context is a target, a desired level of performance component the firm is attempting control.

Control standards need to be objective and consistent with firm's goals. Suppose a firm is about to open its first manufacturing facility in Thailand. It might set the following three control standards for the plant:

Productivity and quality in the new plant will exceed the levels in the firm's existing plants.

After an initial break-in period, 90% of all key management positions in the plant will be filled by local managers.

The plant will obtain at least 89% of its resources from local suppliers.

ii. Measure Actual Performance

The second step in creating an international control system is to develop a valid measure of the performance component being controlled. For the firm introducing a new product in a foreign market, performance is based on the actual number of units sold. For the new plant in Thailand used as an example earlier, performance would be assessed in terms of productivity, quality, and hiring and purchasing practices.

iii. Compare Performance Against Standards

The next step in establishing an international control system is to compare measured performance against the original control standards. Again, when control standards are straightforward and objective and performance is relatively easy to assess, this comparison is easy. But when control standards and performance measures are less concrete, comparing one against the other is considerably more complicated.

iv. Responding to Deviations

The final step in establishing an international control system is responding to deviations observed in step 3. Three different outcomes can result when comparing a control standard and actual performance:

The control standard has been met.

It has not been met.

It has been exceeded.

Depending on the circumstances, managers have many alternative responses to these outcomes. If a standard has not been met and the manager believes it is because of performance deficiencies on the part of employees accountable for the performance, the manager may mandate higher performance, increase incentives to perform at a higher level, or discipline or even terminate those employees.

Approaches to Control Mechanisms

There are seven major approaches for controlling a business organization. These are discussed below –

1. Market Approach

The market approach says that the external market forces shape the control mechanism and the behavior of the management within the organizational units of an MNC. Market approach is applied in any organization having

a decentralized culture. In such organizations, transfer prices are negotiated openly and freely. The decision-making process in this approach is largely directed and governed by the market forces.

2. Rules Approach

The rules approach applies to a rules-oriented organization where a greater part of decision-making is applied to strongly impose the organizational rules and procedures. It requires highly developed plan and budget systems with extensive formal reporting. Rules approach of control utilizes both the input and output controls in an organized and exclusively formalized manner.

3. Corporate Culture Approach

In organizations that follow the corporate culture approach, the employees internalize the goals by building a strong set of values. This value-syndication influences the operational mechanism of the organization. It has been observed that even when some organizations have strong norms of behavioural controls, they are informal and less explicit. Corporate culture approach requires more time to bring the aimed changes or adjustments in an organization.

4. Reporting Culture

Reporting culture is a powerful control mechanism. It is used while allocating resources or while the top management wants to monitor the performance of the firm and the employees. Rewarding the personnel is a common practice in such approaches of control. However, to get the maximum out of reporting approach, the reports must be frequent, correct, and useful.

5. Visits to Subsidiaries

Visiting the subsidiaries is a common control approach. The disadvantage is that all the information cannot be exchanged via visits. Corporate staff usually and frequently visit subsidiaries to confer and socialize with the local management. Visits can enable the visitors to collect information about the firm which allows them to offer advice and directives.

6. Management Performance Evaluation

Management performance Evaluation is used to evaluate the subsidiary managers for the subsidiary's performance. However, as decision-making authority is different from the operational managers, some aspects of control cannot be managed via this approach. Slow growth rates of firms and risky economical and political environment requires this kind of approach.

7. Cost and Accounting Comparisons

Cost and Accounting Comparisons is a financial approach. It arises due to the difference in expenditure among various units of the subsidiaries. A meaningful comparison of the operating performances of the units is necessary to get the full output from this approach. Cost accounting comparisons use a set of rules that are applicable to the home country principles to meet local reporting requirements.

Constraints of Control Approaches

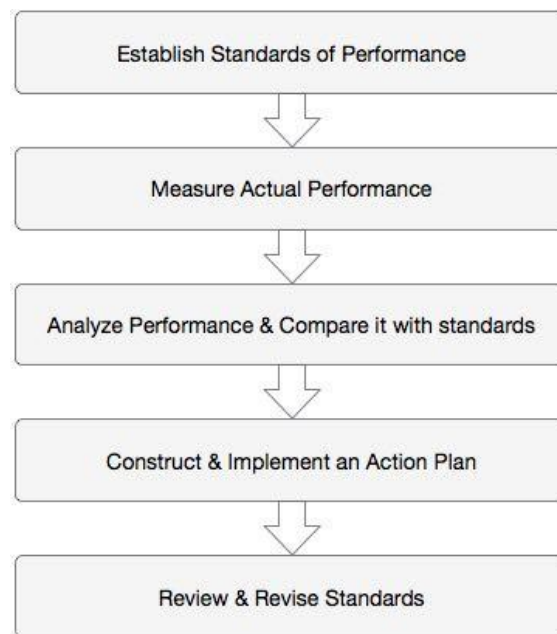
Control mechanisms can never be uniform in every country. International firms have to face severe constraints based on which they modify their control mechanisms in every country. Here is a list of major constraints that affect an organization in setting its managerial control mechanism –

- **Distance** – Geographical distances and various forms of cultural disparities is a big constraint of control systems. Nowadays, email and fax transmissions have replaced the human communication, changing the meaning of distance among units and employees of an organization.

- **Diversity** – It is hard to apply a common control system to everyone due to diversity. It requires the managers to be locally responsive to address the needs of the country in which the firm operates. Diverse attributes may exist in the form of labor, cost, currency, economic factors, business standards, etc.
- **Degree of Uncertainty** – Data relating to the reporting mechanism may be inaccurate and incomplete, raising serious challenges to control mechanisms. Due to uncertainties, control mechanisms must focus on setting goals and developing plans to meet the goals.

Performance of Global Business

It is an important part of every business organization to measure the performance of both employees and the firm as a whole. We will, however, restrict our focus on organizational performance measurement. The standard process of measuring the performance of a global business is as shown in the following diagram –



The prominent features of each stage are discussed below.

Establish Standard of Performance

Standard of performance is applicable to cost, quality, and customer service. More than one standard may be necessary because they reflect expected levels of various units of the manufacturing performance. This includes process yields, product quality, overhead spending levels, etc.

Measure Actual Performance

To measure actual performance, the use of automated data collection systems is suggested to gather information. A standard cost measurement system includes man-hours, machine-hours, and material usage.

Analyze the Performance and Compare it with standards

There must be some set standards to compare the actual performance. The standards should be realistic and achievable. The results of the comparison can be used to apply further rules, targets, and reporting.

Construct and Implement an Action Plan

Constructing and implementing an action plan is key to success. **Variance analysis** can be used to detect potential problem areas. Finding the source of the problem and improving the situation may be useful. Its effectiveness depends on the management's adaptability to the information obtained.

Review and Revise Standards

Review and revise is an important step, as modern organizations are in a constant state of change. If the variances are significant, the performance standards can be adjusted. Effective Performance Measurement must be integrated with the overall strategy. This step requires various financial and non-financial indicators.

Effective Performance Measurement System

For getting an effective performance measurement system –

- The measurement objectives must be owned and supported throughout the organization.
- The process must be applied top-down for maximum benefits. The measures applied must be fair and achievable.
- The measurement system and the reporting structure must be simple, clear, and recognizable.
- The firms need to prioritize and focus to address only the key performance indicators.

Performance Evaluation System

A performance evaluation system must contain periodic review of operations so that the objectives of the firm are accomplished. It is important to have the accounting information to evaluate domestic and foreign operations' costs and profitabilities.

It is not all that simple to measure the performance of an individual, a division, a subsidiary, or even a company as a whole. It is a lengthy and hectic process. The objectives of performance evaluation are to –

- Find the economic performance of the firm
- Analyze each unit's management performance
- Monitor the progress of objectives, including the strategic goals
- Assist in appropriate allocation of resources

Financial and Non-Financial Measures of Evaluation

ROI (Return on Investment) – ROI is the most common method to evaluate the performance of an international firm. It shows the relationship between profit to invested capital and encompasses almost all important factors related to performance. An improved ROI can act as a logical motivator of the managers.

Budget as Success Indicator – Budget is an accepted tool for measuring and controlling the operations. It is also used to forecast future operations. A budget is a clearly expressed set of objectives that guide the managers to set their individual performance standards. A good local or regional budget helps the company to facilitate its strategic planning process smoothly.

Non-Financial Measures – The major non-financial measures that can be used to evaluate performance are – Market Share, Exchange Variations, Quality Control, Productivity Improvement, and Percentage of Sales.

Types of Performance Evaluation Systems

Performance evaluation systems can be of the following types –

- **Budget Programming** – Budget programming is prepared for operational planning and financial control. It is an easy-to-calculate system to evaluate the variance. It is used to measure the current performance in relation to some comparable performance metric from the past.
- **Management Audit** – It is an extended form of financial audit system which monitors the quality of management decisions in financial operations. It is used for appraisal and performing audit for management.

- **Programme Evaluation Review Technique (PERT)** – Based on CPM, PERT delineates a given project or program into network of activities or sub-activities. The goal is to optimize the time spent by the managers. In this process, performance is measured by comparing the scheduled time and the cost allocated with the actual time and the cost.
- **Management Information System (MIS)** – MIS is an ongoing system designed to plan, monitor, control, appraise, and redirect the management towards pre-defined targets and goals. It is a universally acceptable practice which encompasses the financial, budgeting, audit and control systems of the PERT.

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