Strategy and Organizational Structure of Global Companies

Kanji Miyamoto

Professor of Accounting, Faculty of Corporate Intelligence
Osaka Gakuin University

1 Management Accounting System of Global Companies

The management accounting system of global companies should be established in conformity with corporate strategy, under which organizational structure and management process are adopted in the pursuit of each company's strategic objectives.

Mueller *et al.* (1987) point out the following with respect to an accounting information system for multinational corporations (which can be generalized to global companies): "The designer of an accounting system for an MNC must be aware of (1) the organization's nature and purpose, (2) the organizational structure, (3) the degree of centralization/decentralization, (4) the size of the MNC, and (5) management's basic philosophy and attitude toward foreign operations."

Also, Arpan and Radebaugh (1981) give the same opinion as described above: "A firm doing business internationally must thoroughly investigate the decision to be made before making it. This process is more difficult than the similar process for a domestic operation because the variables, alternatives, and unknowns are more numerous. For international operations to be successful, particularly those of a multinational enterprise, considerable attention must be devoted to information system, organizational structure, and control. Each must be carefully designed in itself and in terms of each other to make sure they are suitable and mutually supportive."

However, management accounting is part of an organization's information system which provides all levels of managers in organizations with useful information for corporate strategy and its management. It is necessary in the study of the management accounting of global companies to understand the strategies of global companies, under which organizational structure and management are adopted in the pursuit of its strategic objectives.

This paper discusses the pattern of international organization structure on the premise that the international management system is affected by changes to organizational structure and will change as the organization's structure changes. Thus, the organizational structure and the information system will change as companies transit from being domestic companies to multinational and global companies. Therefore, the change of organizational structure, and its accompanying change of responsibilities, requires an accompanying change in the information system (including management accounting system).

It is necessary to define the terms "globalization" and "global business" used in this paper. The term "global" was first used in Levitt's (1983) article which implied a homogenized global market in terms of consumer needs and preferences. Yet the global refers to more than markets and is used to indicate global industry, global strategy, and global management. A global market refers to one which has broadly similar consumer needs and product preferences. A global industry is one which is a global configuration of value-adding activities within an industry. A global strategy which is used by Bartlett and Ghoshal (1989) as the term "transnational strategy" is one which develops global competitiveness, multinational flexibility, and worldwide learning capability simultaneously.

Chandler (1962) pointed out that structure follows strategy. The appropriate structure is to make strategy and its management work better. As companies transit from being domestic companies to international companies, they must cope with geographically dispersed operations, diverse social, cultural, political, legal, economic environments, and divergent trends in different countries. A domestic company does not have these challenges and so its organization structure is not appropriate for an international company. An appropriate organizational structure for an international company depends on its strategy to cope with increased global pressures.

As a result, according to Channon and Jalland (1979), "There is no one optimal organization form which should be adopted by the MNC. Rather the structure should be consistent with strategy in so far as this is possible. Moreover, since strategy itself tends to change over time so might organization structure expect to undergo modifications."

2 International Business Activities of Domestic Companies

At first, international operations of domestic companies begin with export sales to other countries. If such companies are organized along functional lines, export sales management is established along with domestic sales management in the sales department. On the other hand, if diversified domestically, the export sales division is established along with domestic product divisions and exports management tends to be centralized in order to be served by foreign sales specialists while domestic sales are serviced by sales managers of each domestic product division. It is not economical for each domestic product division to have an export specialist. The export sales division is also given responsibility for licensing and is treated as a profit center as well as production divisions.

An export sales division, however, suffer from two weakness. First, the export sales division is dependent on domestic divisions for both products and technology. Since the later concentrate their attention on domestic markets and limit their interest for foreign markets, they do not allow responsiveness to foreign markets based on sensitivity to their needs. Second, an export sales division functions effectively to further foreign market expansion through subcontracting and foreign direct investments because of the lack of experience in managing foreign operations.

As the companies' exports increase, each importing country's government begins to encourage local production by imposing restrictions such as tariffs and quotas. The exporting company establishes a production subsidiary inside the foreign market in order to protect its market share. The management of the foreign subsidiaries is given unlimited powers of decision and action as the parent company does not have sufficient international experience to manage the foreign operations. The foreign subsidiaries report directly to the chief or other top executive of the parent company. When the international operations change from export sales to a mix of export sales, licensing, and oversea production, the export sales division is not able to handle the management of the international operations efficiently.

3 International Division Structure

The parent company does not intervene in the operations of foreign subsidiaries as far as they earn profits and remit dividends. Therefore, the management of foreign subsidiaries is independent. But when foreign sales and manufacturing operations increase, the need for coordination between such operations and domestic product divisions becomes much greater. Moreover, there is a growing need for decisions regarding such opportunities as licensing, joint ventures, and foreign direct investments. As a result, the export sales division is developed into an international division in order to consolidate all the foreign operations of the company. According to Davis (1976), "When a corporation has four or more foreign manufacturing operations, it is likely to place them all into an international division, reporting to a single executive".

The international division is usually subdivided by geography and manages exports, licensing, subcontracting, foreign branches, and foreign subsidiaries. The head of the international division is generally delegated total authority and responsibility for the international operations from a senior executive at corporate headquarters. The international division is a profit center as well as domestic product divisions and makes up policy and strategies planning for international operations. A representative organization diagram for a company using an international division structure is shown in Figure 1.

There are several advantages with the international division structure. First, it coordinates all the international operations so as to raise the level of performance above that where foreign subsidiaries are autonomous. Second,

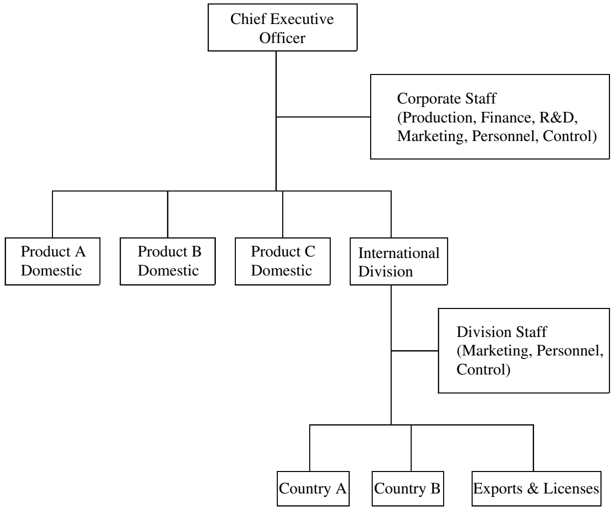

Fig. 1 International division structure

foreign operations are generally more complex than domestic operations. The presence of an international division forces managers to develop expertise in foreign operations. Third, since the international division is given generally total responsible for profits and losses of the foreign operations, its managers make top management cognizant of the results of decisions on international operations and the best overall corporate strategy for international profits.

There are, however, several disadvantages with the international division structure. First, the international division structure is the separation of domestic product divisions' managers from its international division's counterparts, which may turn out to be a drawback as the company will expand international operations. Second, as the international division centralizes many decisions of foreign operations, the competitive position of the foreign subsidiaries may be reduced by the time lag in securing decision from it. Third, because the international division does not have its own product development and research and development experts, it relies upon support from the domestic product divisions. But, as the domestic product divisions are evaluated solely by their domestic performance, they frequently become reluctant to supply what the international division needs. The continued foreign expansion of the company through foreign direct investments brings about the inherent conflict between the domestic product divisions and the international division. For example, capital budgeting and transfer pricing are substantial issues. This has led most companies to replace their international divisions with global structures to realize gains by coordinating and integrating operations on a worldwide scale by taking advantage of economies of scale.

4 Global Organizational Structures

In many industries, competition is on a global basis, with the result that companies must be responsible for the worldwide operations and use global structures. Global structures may be organized on functional, product, or geographical lines of responsibilities.

4.1 *The global functional structure*

The functional structure has been the form most often used by European companies. The global functional organization is organized by functions such as production, marketing, finance, research and development, and other functions. The heads of these functions have worldwide line responsibility for operations and management.

The global functional organization has the advantage of tight control over specific functions worldwide. It allows a relatively small group of officers to bring out competitive strengths in each function. The functional structure works rather well when companies remain comparatively small and have a few lines of products. However, this type of structure has some serious weaknesses. Coordination of functions is difficult, as this structure separates, for example, marketing from manufacturing. Subsidiaries normally have to report to several different persons at headquarters, resulting in tremendous duplication of effort. Finally, the structure is unsuitable for multi-product or geographically dispersed organization as each function may need its own product or regional specialists. As a consequence of such weaknesses, many companies organize their organization structures on product or geographical lines of responsibilities.

4.2 *The global geographic structure*

The geographic structure organizes the company on the basis of the geographical areas where it operates. Each area division has both product line and functional responsibility for all operations within its area, and corporate headquarters retains responsibility for worldwide strategy. A representative organization diagram for a company using a global geographic structure is shown in Figure 2.

The geographic structure is highly suited for mature businesses with narrow product lines but with geographically dispersed operations, because their growth potential is greater in abroad than in the domestic market where the products are at later stages in their life cycles. This structure also works well where the product is highly standardized, but techniques for penetrating markets differ. Therefore, it is essential for area managers to possess intimate knowledge of local conditions, constraints, and preferences. Worldwide standardization and area variegation may be incompatible. However, Davis (1976) pointed out that the major advantage of a global geographic structure was its ability to differentiate regional and local markets and determine variations in each appropriate market mix.

A geographic structure develops control systems that each local subsidiary is evaluated by the contribution toward the area division and the subsidiary managers need to be motivated to act in the best interests of the area division.

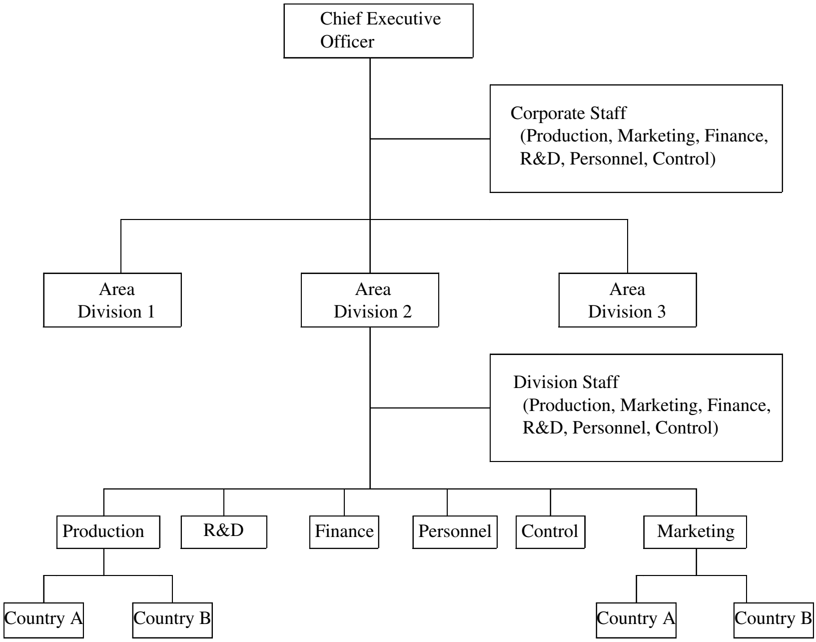

Fig. 2 Global geographic structure

A geographic structure usually requires the duplication of functional and product specialists at each area headquarters. This may create high organizational costs. This structure also may result in necessary information not reaching corporate headquarters because of the area managers' focus on area performance. Company's worldwide interest may therefore be opposed.

The structure also insulates one geographic unit from another, which may make it difficult to transfer new technologies, new product ideas, and production techniques across markets. When the company has a diverse product range, the geographic structure may become inappropriate.

4.3 *The global product structure*

The product structure is adopted by companies with multiple product lines. Every product comprises a division that is given worldwide responsibility for its design, production, and marketing. Consequently, each of the product division has its own functional, environmental, sales, and manufacturing responsibilities and functions as a profit center. Corporate headquarters

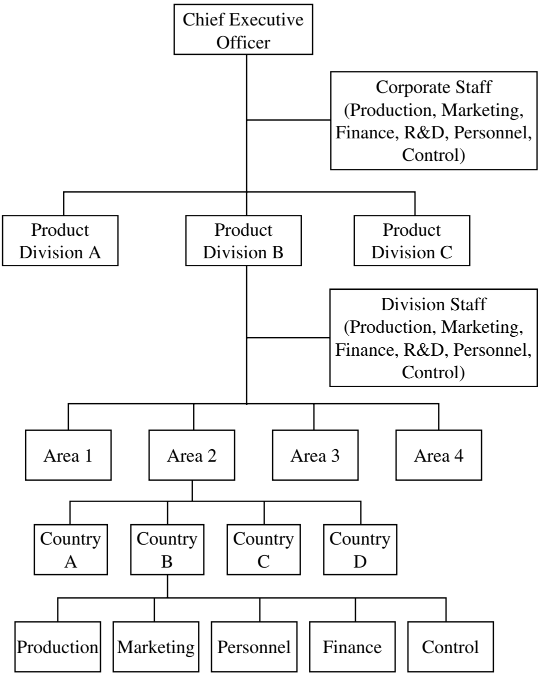

Fig. 3 Global product structure

sets overall goals and strategies for the company. These corporate guidelines provide both the protection and the constrains under which each product division is expected to formulate divisional plans by having its own functional staff. Such a structure is shown in Figure 3.

The global product structure works best when a company's product line is highly diversified, when the product divisions seldom use common marketing tools, channels or promotion, when a high level of technological capability is required, and when there is significant need to globally integrate production, marketing, and research related to the product.

The major advantage of the global product structure is the ease of flow of technology and product knowledge from the divisional level to the foreign subsidiaries. It is also advantageous when local labor cost and skill level, tariff and tax regulations, shipping costs, or other considerations facilitates the coordination and integration of production in different countries in order to produce the highest quality at the lowest cost.

The main weakness of a global product division is the duplication of facilities and staff groups that each division requires to support its own operations. Another is that worldwide responsibility is assigned to managers with particular product expertise but whose experience has been largely domestic. These managers have limited knowledge of geographic markets. Thus, the emphasis of the division may be on the domestic market.

A similar weakness is that the lack of experience and capability for dealing with international operations may create difficulties in assessing environmental conditions in foreign markets. Another weakness of the product structure is the difficulty of coordination and integration of the subsidiaries' activities in any given area.

4.4 *The global mixed structure*

A mixed structure combines two or more organizational dimensions simultaneously in order to make the most of the advantages of each global structure and to minimize the weaknesses of one.

Companies with a global geographic structure coordinate all product lines within each area, but at the expense of coordination between geographic areas for any one product line. For example, when they embark on placing a new product line in the market, each area division may not make discrimination in sales of the new product line as the line is generally small when considered a proportion of the whole within its division. Thus, they introduce a means to manage the new product line from a worldwide point of view as distinguished from geographical area management.

According to Davis (1976), companies with a global geographic structure introduce global product line management into their organization design, facing following reasons and conditions:

- sharp difference in marketing or production and supply;
- little or no interdependence between the main line and the new one;
- currently small, but potentially large, growth of the separated product; and
- to avoid rivalry and hostility among managers in the different products.

Companies with a global product structure have the opposite problem to companies with a global geographic structure. The global product structure satisfies the need to maximize technological linkages among the plants in each business unit which is diversified by each product line in the world.

This has, however, the weakness which is not able to coordinate subsidiaries' activities in each area. To cope with problems of coordinating this parallel management, companies must introduce geographic management in their existing product structure.

According to Davis (1976), companies with global product structure need to coordinate their operations in each area when

- they have at least two significant but organizationally independent business units there;
- there are economies to be gained from pooled information;
- there are benefits derivable from a more unified corporate identity;
- there is a discernible need for assessing and coordinating corporate programs and their implementation.

Global companies that are organized along product lines may subsequently have regional groupings or companies with a global geographic structure may have subsequent product groupings. However, coordination and simplicity across such structures are not kept for a long time because of complications and difficulty for managers to handle. The main weakness of the mixed structure is the duplication of various activities, which may be expensive.

4.5 *The global matrix structure*

Each of the four global structures discussed has advantages but also weaknesses. In order to preserve the advantages of each of these structures and to overcome their weaknesses, many global companies adopt global matrix structures which provide for a three-dimensional linking or overlapping of functions, areas, and products.

Under this three-dimensional structure, power and responsibility for global operations are shared among product divisions, geographic areas, and functional areas. A matrix structure is shown in Figure 4, which shows an arrangement whereby products in three product groups are sold in six geographic areas. Responsibility for a proposed expansion of sales of industrial equipment in the Far East is divided among an industrial equipment manager, a Far East regional manager, and finance and marketing managers at headquarters.

A foreign subsidiary manager may report simultaneously to an area manager as well as a product manager. A product manager shares with

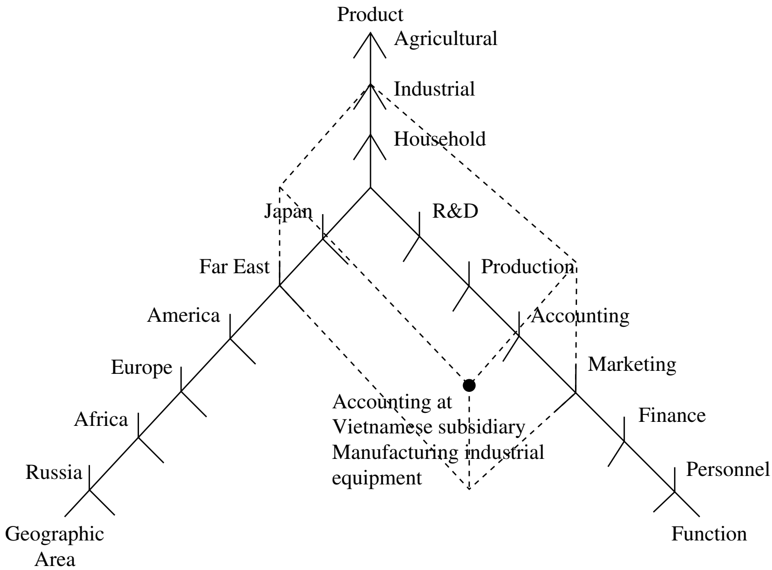

Fig. 4 Global matrix structure

an area manager responsibility for the profits of the foreign subsidiary. Managers must recognize the need to resolve issues and choices through frequent interchanges between the product and regional divisions.

In a matrix, the organization must adopt some fundamental changes in technical systems and management behavior and requires a commitment on the part of top management to the essential preparation required for it to be successful. It chooses two or more dimensions as the basis for grouping its operations.

The global matrix structure is one means of achieving global coordination and local responsiveness and is adopted if conditions such as the following exist:

- there is a diversification of products and areas;
- the opportunities are lost and significant problems created by favoring either the product or area dimension;
- two or more product, area, or functional divisions require the shared use of scarce resources;
- information, planning, and control system operate along the simultaneous consideration of functional, product, and area concerns;

- product and area demands require enriched information processing capacity because of uncertain, complex, and interdependent tasks.

An advantage of the matrix structure is that it forces the company to respond to all the important business factors, which can help to achieve both global coordination and national responsiveness simultaneously. In the matrix structure, reporting duplication with managers reporting to two or more bosses leads to more conflicts and confusion. Overlapping responsibilities have managers shirk their responsibilities. Also, the matrix design does take excessive time on decision-making process and increased administrative costs.

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