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Management Accounting Information for Consolidated Group Management

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1. Introduction

Japanese companies can be roughly divided into two types: (1) corporate groups that were formed before World War II, such as Mitsui, Mitsubishi, Sumitomo; and (2) corporate groups that are affiliated with city banks, such as former Daiichi Kangyo Bank, Fuyo (former Fuji Bank, former Yasuda Bank) and the former Sanwa Bank. The business relationships among the large companies in these groups are only fair and not direct in many cases. However, for business groups that place large companies in the center, the business relationships between the large companies and their associated small/medium companies are close. The other type of corporate group is the vertical group, in which the parent company is at the top, as is the case at Toyota, Hitachi, Panasonic, Canon, and so forth. These groups are based on business operating relationships and close connections between the constituent companies.

In recent years, in both types of corporate groups, many companies have been split to delegate the authority for speedy decision making, to ensure complete responsibility for own profit/loss, and to reduce the fragmentation of effort required for the launching on new business ventures and the development of new products. When a company is broken, the bad assets are often retained at its headquarters. Therefore, the delegation of authority and company fragmentation may produce some good results but may also weaken the headquarters of the company. In addition, the company may encounter problems with the pursuit of local optimization at each company, synergy creation in subdivisions, waste of resources, and increase of adjustment costs.

The group headquarters has to optimize its functions and manage from the view of the whole group rather than that of the parent company. For some companies, the effects of decentralization can be detrimental, forcing revision of management methods and even reconsideration of the decision to decentralize. In this paper, the group headquarters is in charge of the management of the entire group.

The purpose of this paper is to examine the methods that can be used for group management from the standpoint of management accounting, with a consideration of the role of the group headquarters. In particular, the characteristics of management accounting information that facilitate group management and the design and use of consolidated performance evaluation system are discussed. In Japan, the ban on pure holding companies was lifted in principle in 1997, and some companies subsequently adopted this system. For a company that seeks to change to this type of company structure, it is usual to start as an operating and holding company that runs its own business and is managed like a pure holding company. In any case, many companies currently execute such group management now. Therefore, I consider this paper taking this type into consideration.

2. The Role of Group Headquarters and Three Types of Group Management

2.1. *The importance of “management of dispersion and unification”*

The group headquarters functions to

- (1) Adjust and unify the component businesses from the view of the whole group, while promoting the self-management of group companies.
- (2) Develop the new businesses and to abolish defunct businesses.
- (3) Cooperate and conduct the joint development projects with companies outside the groups.
- (4) Support the companies in the group.

The philosophy underlying these roles of the group headquarters relate to balanced “management of dispersion and unification.”

For the management to promote self-management, management methods such as clarification of the individual missions of each company,

delegation of authority, clarification of the ranges of responsibility and authority, introduction of market mechanism, and clarification of performance evaluation standards must be implemented. For reinforcement of group centripetal force, management methods such as the clarification of missions and the unification strategies across the entire group, information sharing, joint responsibility for ethics, personal exchange, common training programs, and consolidated performance evaluation are required.

For management of dispersion and unification, it is necessary to combine both management methods in a satisfactory manner. From the standpoint of management accounting, I think it is important to consider carefully the formulation of group missions and unification strategies, the establishment of individual missions and strategic goals in each company, the design of appropriate performance evaluation systems in which the ranges of authority and responsibility are considered, and the procedures for accounting information sharing and mutual communication.

2.2. *The three types of group management and the roles of the group headquarters*

Group management can be roughly divided into three types. The management of dispersion and unification is necessary for all the types listed below, and even within a single type of group management, the emphasis placed on dispersion and unification may be quite different.

The first type of group management is that led by a group headquarters (Type I), which not only formulates and transmits group missions and group strategies, but also decides on the missions and concrete targets for the headquarters business divisions and group companies. The concrete measures applied by the business divisions and group companies are decided by themselves. The group headquarters allocates a role to each company, to achieve synergy among the companies in the group, and to attain global optimum. Both periodic performance evaluations and intra-period controls are performed, and management is executed based on detailed information. From the evaluation results, essential businesses are established and superfluous businesses are abolished. Information sharing is promoted between the headquarters and group companies, and the group headquarters decides the necessary technology and support in terms of funding, tie-ups, and so forth.

The second form of group management is led by business divisions and related companies (Type II). In this organization, the group headquarters not only formulates and transmits group missions and group strategies, but also defines the individual missions for the business divisions and related companies. However, the group headquarters does not decide on concrete strategy targets, and the business divisions and related companies manage independently. In addition, the group headquarters introduces a market mechanism, manages the overall group, and executes performance evaluations regularly. The *de novo* establishment and abolition of businesses are performed based on the evaluation results. Information sharing and cross-sectional evaluations are carried out as much as possible to maintain the centripetal force of the group. When requested by a business division or a related company, the group headquarters may support a new technology, a fund scheme, or a plan to strengthen the business.

The third form of group management is financial management (Type III). The group headquarters transmits group missions and group strategies to maintain centripetal force. As the relationships between the individual business divisions and related companies may be poor and they may lack common strategies, there may be little synergy between them. The group headquarters executes only a periodical performance evaluation and decides on the direction of the business. Upon receipt of a request from a business division or a related company, the group headquarters may support a new technology, a fund scheme, or a plan to strengthen the business.

Hitachi is divided into the M (management) consolidated company, V (vision) consolidated company, and F (financial) consolidated company. The M consolidated company performs strategic management within Hitachi with regard to pursuit synergy. The V consolidated company leads businesses that share a management vision and brand and that are members of the Hitachi group. The F consolidated company executes only financial consolidation.

2.3. Functions of the group headquarters

The functions of headquarters can be divided into functions related to the management of the overall group and functions that support the group businesses and related companies. Moreover, the former can be divided into activities of strategic formulation and adjustment, resource allocation, and strategic control. The operational details of these three

activities depend on the type of the group management used, as described below.

Strategic formulation and adjustment:

- (1) Strategic formulation and communication of the vision, missions, and strategies of the whole group; for all types of group management.
- (2) Formulation and communication of the business divisions and related companies; for Type I and Type II.
- (3) Establishment and indication of the individual goals of the business divisions and related companies; for Type I.

Resource allocation:

Investigation of an optimal group management system and formulation of a resource allocation plan; these activities should always be executed for Type I group management, and should be performed as the circumstances demand in Type II and Type III.

Strategic control:

- (1) Decisions as to performance evaluation indicators; for all types of group management, with detailed decisions for Type I.
- (2) Monitoring accomplishment of overall goals and each divisional goal in the intra-period; for Type I.
- (3) Interpretation of enforcement results and performance evaluation and decisions as to rewards; for all types, although the grasping detailed results and evaluation is needed for Type I.

Support functions, which are implemented to support the businesses in the group and the related companies, include personnel affairs, accounting, legal affairs, personnel training, technologic support, intellectual assets strategies, and research and development particularly basic research and high-risk, high-return studies. These operations are necessary for all the group management types.

3. Group Management and Management Accounting Information

3.1. Group performance accounting

The objectives of accounting for group decision making are outlined in points (1) and (2) of *Strategic formulation and adjustment* (Section 2.3),

and in *Resource allocation* (Section 2.3), if group support functions are excluded. In contrast, the objectives of group performance accounting are covered by point (3) of *Strategic formulation and adjustment* (Section 2.3), and in *Strategic control* (Section 2.3). In this paper, I focus on group performance accounting.

In performance accounting, the establishment of goals, the performance evaluations, and performance control over a short period are the most important issues. Of course, the short-term goals must be consistent with the declared strategies, individual plans, and long-term goals. However, in recent years, the importance of an emergent strategy has been emphasized, and the domain of performance accounting is no longer considered to be narrow but is expected to expand in accordance with the business strategy. As indicated in Fig. 1, performance evaluation for a short period is designed to take into account the strategies, and the performance evaluation results are considered to influence strategy formulation. In other words, the group evaluation system has handled relations of (a) in Fig. 1 traditionally, but to consider the relations of (b) in Fig. 1 is important.

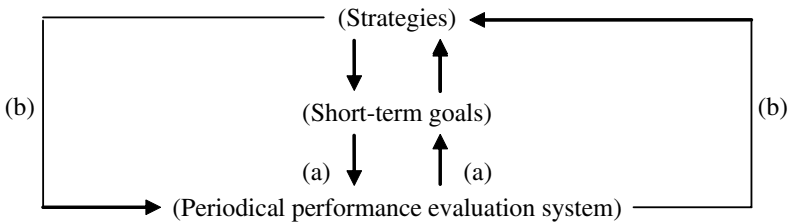


Fig. 1. The relationship between strategies and the periodical performance evaluation system.

3.2. *Characteristics of performance accounting information that are useful for group management*

In this section, I will comment on the usefulness and characteristics of management accounting information based on the characteristics of group performance accounting described in the previous section.

The group headquarters not only informs about the financial goals (group goals) in the short term. However, it is also important to clarify the relationships between the group missions and group strategies, so that the division managers and company managers understand their individual

missions. Thus, they understand the roles of their own division and company by understanding the direction of the whole group and their own stand-point, which allows them to evaluate the current situation and results in an autonomous manner.

In the group headquarters-led model, the headquarters informs the business divisions and related companies of their goals and their performance evaluation indicators, and allows them to report in detail regularly (every month), while at the same time permitting them to report necessary information on a weekly, daily or real-time basis. In the business divisions/related companies-led model, the headquarters informs these units only regarding performance evaluation indicators, and allowing them to report results regularly (every month), while providing the opportunity to report weekly or daily if necessary. In the financial management model, the headquarters allows the companies to report results regularly (every month).

For group headquarters-led management and business divisions/related companies-led management, it is necessary to clarify the issues of authority and responsibility, since this dictates the positioning within the overall group and increased autonomy. Moreover, since various forms of businesses are carried out in the group, it is important to define unambiguously using a matrix the relationships between the functions of the headquarters/related companies and the various businesses, and to manage regarding a factor of the matrix as a business unit (responsibility center). In addition, authority and responsibility are decided by considering the relationships between the functions and businesses. When a bundle of business units is small, it is good to be able to consider plans and measures concretely, but it is not possible to consider from a general point of view and to consider synergy in a wide range. On the contrary, when a bundle of business unit is large, it is possible to consider goals and synergy from a general view, but it is difficult to consider concrete measures.

It is necessary to determine in advance transfer prices, internal interest rates for fund raising from headquarters, the calculation method for internal dividends on adopting an internal capital system, and the allocation methods for corporation expenses occurred in the business divisions and related companies, to compute the profit/loss for the headquarters, each functional division at the headquarters, and each related company, as well as the profit/loss for each business division and business. It appears that clear definition of these parameters make it easier for the constituent units to act autonomously. Of course, these performance calculation methods

need to be consistent with not only the short-term goals, but also the strategies of the whole group.

Accounting procedures for performance evaluation should be conducted fairly. Cost burden rules often tend to be different. For example, internal business divisions bear the common costs of the headquarters, while related companies do not. Internal business divisions also often have courtesies which are mutually beneficial but unofficial arrangements, while related companies do not. It is important to standardize these accounting procedures.

It is necessary to expedite reporting by standardizing accounting procedures. For the purposes of managing, complete information is not essential, as estimated values or predicted values can be used.

4. Example of Using a Performance Evaluation System for Group Management

An appropriate performance evaluation system is essential for the procurement of useful performance accounting information. In recent years, the numbers of overseas subsidiaries in global companies, such as electric companies and office machine companies, which deal with many products, have increased, such that integral information on the businesses at home and abroad has become crucial. When the horizontal and vertical divisions of labor systems are taken, not only the evaluation of each company and each function, but also the evaluation of each business is necessary, as I mentioned in the previous section. One example of a matrix evaluation system is provided by Canon.

At Canon, most of the sales and production activities are carried out by subsidiaries. The business divisions do not have their own production and sales companies. Essentially, a single production company produces the products of some of the business divisions and all the sales companies sell the products of all the businesses. In light of this corporate structure, the matrix performance evaluation system was introduced for the following reasons.

- (1) When the independent management system of each business division becomes too strong, some production companies and sales companies are built by business division in the same area, with the potential for increased wastage of resources.
- (2) Business divisions need to run businesses not only from the view of their own business, but also from the overall view.

- (3) As production companies are in charge of some businesses and sales companies execute management by channel, a unified management is necessary.

The profit/loss made by each company and each business division are computed in this evaluation system, and management aimed at maximizing both of these parameters is enabled. Since close communication is important in matrix management, the directors of the business divisions regularly visit the sales companies and production companies, to exchange information and to share group accounting information.

At Murata Manufacturing, the profit/loss levels of each department and each product (consolidated profit/loss for each product) are calculated, and two-dimensional matrix management based on these parameters is executed. The department profit/loss in the company is the starting point for profit/loss management and is a generic term for profit/loss by process, by place, and by corporation. Murata Manufacturing differs from Canon in that its matrix evaluation is enforced in detail within the company. Research and development, business planning, and general management are conducted intensively in the headquarters. If these activities are added, the management becomes three-dimensional.

During the calculation of department profit/loss, cases may arise in which a general administration/sales department and a research and development department at the parent company and some of the subsidiaries conduct their activities at a location other than their usual place of business. In such cases, the costs are assigned directly or allocated adequately among the divisions and corporations. In the calculation of consolidated profit/loss for each type of product, general administration/sales costs and research and development costs are assigned directly or allocated by received benefit beyond the position. The budgets and actual profit/loss results are controlled monthly.

The main rules for profit/loss management are established unambiguously. These rules include transfer prices, which are decided using an addition method. However, a special price is set when a product cannot be sold at the transfer price. This method has been adopted because it guarantees the gross margin for the headquarters, and limits losses for the subsidiaries. In addition, transfer prices are determined in yen, to make overseas companies susceptible to exchange rate fluctuation. Moreover, an interest rate system is introduced, which means that funds for equipments/inventories and all the working capital are supposedly borrowed from the

headquarters, so that interest can be charged. However, the internal capital system is not adopted. This system is peculiar to Japan and its purpose is to assign intra-divisional capital and to allow the divisions to act autonomously as independent companies. When the internal capital system is adopted, it will let you misjudge because the past profit is reserved as surplus funds. Furthermore, standard costs are calculated and used to set the sales prices and intra-transfer prices, as well as for cost management, budgeting, and inventory evaluations.

The knowledge gains and the points to be considered from these examples are as follows:

- (1) The consolidated performance evaluation system is useful in generating a unified consciousness across the group, and it should be devised as strategic executive means, as well as evaluation of the achievements in the short term.
- (2) For the matrix organization to be the premise underlying matrix performance evaluation, the issues of authority and responsibility need to be clarified, to facilitate autonomous management.
- (3) For autonomous management, transfer prices to evaluate performance and allocation rules for common costs and corporate costs must be established.
- (4) Consolidated monthly closing procedures must be adopted, and an information system should be devised to disseminate important information as soon as possible, weekly and daily.
- (5) Information sharing is necessary for matrix management. Therefore, it is important to establish a location for communication.

5. Using Management Accounting Information to Generate Synergies

It is necessary for the group headquarters to generate value that is greater than the sum of the values of the parts, so that group management is effective. Therefore, it is important to generate synergies. Group missions and visions give definitive guidelines for the value to be created by synergy. In addition, it is important to monitor continuously the situation of each business, so that synergy is created. Group synergy comprises planned synergy and emergent synergy. Planned synergy is expected at the time of planning, whereas emergent synergy emerges during the enforcement process and cannot be anticipated at the time of planning. Synergy arises

from joint ownership of know-how, strategic adjustment, joint ownership of tangible assets, and concentration of negotiating power.

When synergy effects are estimated, the effects and feasibilities tend to be overestimated and the costs tend to be underestimated. Therefore, managers need to analyze more carefully the synergy effects and the associated financial costs, and to evaluate these items using a consolidated performance evaluation system, as mentioned above. The evaluation does not have to be strictly accurate. The effects of synergy are linked to increased profit and reduced costs.

In this section, I will consider the relationships between emergent synergy and performance accounting information. The places in which creativity is stimulated and promoted are indispensable for the generation of emergent synergy. It is extremely important that information and knowledge are allowed to flow within the group and are used diversely, and that devices and places are established in which information and knowledge are considered and linked freely. Therefore, it is important to build networks of human information and knowledge and to use personnel system.

Professor Yoshiya Teramoto mentions that the following items are necessary for the organization of learning, presupposing autonomous diversity of the organization members.

- (1) Knowledge sharing, which is the sharing of explicit knowledge, tacit knowledge and sense of value;
- (2) Holistic viewing;
- (3) Flexible networking, which the flexible linkage and combination of people and organization; and
- (4) Hypothetical experimenting, which involves the proposing of hypotheses regarding countermeasures and verification through experimentation.

Considering the generation of synergy from the stand-point of performance accounting using this way of thinking, it is necessary to establish the places that are used to accumulate performance accounting information and that facilitate knowledge sharing. To produce emergent synergy, reporting and communication only in the top and bottom directions, but also in the right-and-left directions are important. In addition, it is important to collect management accounting information in all locations at all times, and to educate users. Moreover, it is necessary to generate not only management accounting information, but also qualitative information.

From a holistic view, it is necessary that the goals of the overall group, those of each division, and the personal goals are consistent, and that achievements can be evaluated as needed. It is important that management accounting information is provided in a timely fashion. For flexible networking, the measurement of effects through the connection of persons and the organization is needed. For hypothetical experimentation, it is necessary that the influences of the measures that correspond to the various situations regarding profits and costs can be measured using simulations.

6. Summary and Conclusions

Group headquarters plays various roles. I believe that it is essential for group companies to be integrated while acting autonomously, and it is essential that they are managed from the overall view. I have discussed how valuable balanced “management of dispersion and unification” is for the field of management accounting, as well as the features and effective uses of useful management accounting information. In addition, I have considered how best to design and use a group consolidated performance evaluation system, so as to promote the management from the overall view.

I have emphasized the importance of defining clearly the group visions and the visions of each business division/related company, so as to encourage these units to act autonomously while maintaining a sense of unity. The authority and responsibility within each business unit, as defined by two axes, i.e., company (function of the company) and business, as well as the evaluation standard of the unit, should be clarified. In addition, it is indispensable to clarify the transfer prices and allocation rules for common costs and corporate costs.

I consider the matrix evaluation system to be effective, since various forms of business are executed in group companies and not only the performance of each company, but also that of each business beyond the company is needed. Establishing an appropriate performance evaluation system facilitates the maintenance of the centripetal force and autonomous management. As examples, I have mentioned Canon and Murata Manufacturing.

The evaluation system should be used not only to evaluate consolidated performance, but also to generate group synergies, i.e., planned synergy and emergent synergy.

Regarding further group management, conflicts, such as those related to transfer prices, will occur if an individual business division and each related company is overemphasized in performance evaluation, since subsidiaries and related companies are linked by the flow of trade. Therefore, relative importance attached to consolidated performance evaluation or performance evaluation of each business division/related company is crucial. Although I also considered the focusing of intra-group companies, consideration of the relationships with the companies outside the group is also necessary.

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