

Foreign Subsidiary Control Systems of Japanese Companies in Indonesia

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1. Introduction

An increasing number of foreign subsidiaries are dispersing all over the world from Japan. Especially, these many subsidiaries are located in Asia. China is the most important location for these Japanese subsidiaries. Now, other Asian countries are attractive locations for them.

These Japanese subsidiaries locate far from Japan and also social infrastructure systems are different from Japanese ones. But Japanese company must attain high financial performance in the consolidated financial statements for various stakeholders. In order to attain this high performance, Japanese companies exercise rigid control to their foreign subsidiaries.

In this paper, I consider the control system structure for subsidiary. Many subsidiaries in Asia were visited for this research. There are such research results as 7 subsidiaries in China, 1 in Vietnam, 7 in Indonesia. Based on the latest interview in Indonesia, this paper shows the essence of Japanese subsidiary control system in Indonesia.

2. Research Focus

According to Jaussaud J. and J. Schaaper (2006), they summarize an inventory of studies on control of subsidiaries abroad. The paper clarifies research methodologies based on literature review. As a result, they show there are a few researches about performance and behavior control of subsidiary in previous studies.

Ghoshal, S. and C.A. Bartlet (1990) propose very meaningful insight about subsidiary control. They point out the control of subsidiary from the viewpoint of network. Especially, Japanese multinational corporations (MNCs) disperse many subsidiaries in Asia. These subsidiaries have individually their own business roles in their countries. And also, Japanese manufacturing MNCs intensively locate subsidiaries in Asia. In this situation, the viewpoint of network is very meaningful for the paper.

In the textbook by Gray et al. (2001)., control aspects of global business are discussed from many perspectives. It is clear that we need to identify the importance of control mechanism in global business.

As these previous researches show, subsidiary control can be analyzed from many perspectives. For example, expatriate plays an important role in subsidiary control system. From another perspective, this paper mainly focuses on financial-oriented control systems which headquarter exerts to the subsidiaries in

Indonesia. The essence of Japanese subsidiary control system in Indonesia will be shown later. As mentioned, all interviews were implemented in Indonesia. Based on these interviews, a qualitative analysis is employed in this paper. The essence of subsidiary control systems in Japanese companies and its critical issue will be discussed.

3. Basic control system structure

In management accounting, control system is referred in the context of management control. Anthony and Welsch (1981) notice, there are three different types of planning and control processes. They are (1)strategic planning, (2)management control and (3)operational control. This management control is defined as the process by which management assures that the organization carries out its strategies effectively and efficiently¹⁾. This management process is applicable to the relationship between Japanese headquarter and foreign subsidiaries in this multinational corporation. This group of headquarter and subsidiaries is consolidated into corporate group. Management in Japanese headquarter must affect the manager of foreign subsidiary toward the right direction in which MNC's overall strategy is realized. If this is possible, each subsidiary can attain high financial performance of MNC as a whole. This relationship is as follows.

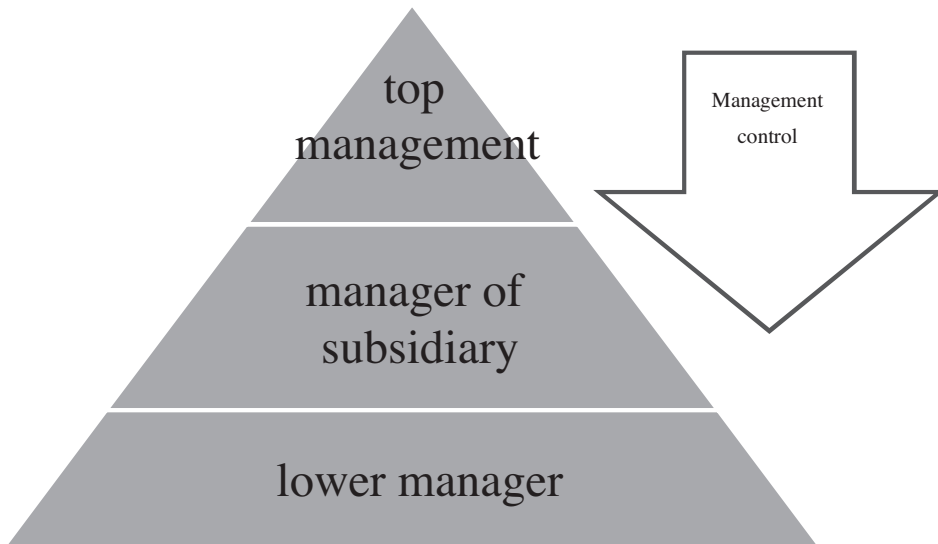


Figure1. Management Control Structure in MNC

Top management shows top management in Japanese headquarter and middle shows foreign subsidiary manager. Like this figure, top management controls manager of subsidiary by many management tools.

For management control, many management tools are used. As management tool, many types of management accounting information can be used to subsidiary. For example, budget is the most typical management accounting tool for subsidiary. This budget is used as one of principal performance measures for subsidiary manager. This budget is compared to actual result. In this situation, there are four

responsibility centers which can be applied to analyze budget variance.

- (1) Cost center···Cost budget is compared to actual result of cost.
- (2) Revenue center···Revenue budget is compared to actual result of revenue.
- (3) Profit center···Profit budget is compared to actual result of profit.
- (4) Investment center···Profit is compared to actual result in relation to investment.

This comparison between budget and actual result is basis of performance evaluation but there are some different ways of comparison. Based on the interviews in Japanese subsidiaries, foreign subsidiary control systems of Japanese Companies will be shown in the next section.

4. Data

As mentioned, I visited many Japanese subsidiaries in Asia with my colleagues for research. We visited 7 subsidiaries in China, 1 in Vietnam, 7 in Indonesia. In this paper, I focus on the data of Indonesia because these interviews were lately implemented in 2010. Others are older than these. In relation to Indonesia, many Japanese companies start business here recently and rapidly. Indonesia is very prospective market and manufacturing base, too. This is very good model case of foreign subsidiary control systems of Japanese MNCs.

In 2010, I and my 2 colleagues²⁾ visited industrial park near Jakarta in Indonesia. About 100 companies located there. We could interview the essence of control system structure to subsidiary managers there. In the almost of the subsidiaries, we held these interviews with the president directors of these subsidiaries. It took about one hour to finish the interview with them. Real opinions of local subsidiary managers could be verified, not headquarter managers. This interview style has great contribution to the research insight.

As this research was a part of the international joint research with French colleagues, we asked the same questions for Japanese and French subsidiary in Asia.

In this interview, our questions consist of 5 parts as follows. Totally, this includes 19 questions.

- (1) Company profile
- (2) The role of long term expatriate
- (3) Formalization
- (4) Budget
- (5) The role of short term expatriate

Control system is regarded as performance evaluation system in management accounting. Like this, performance evaluation system of subsidiary is critical issue of this paper.

Part (4) must be considered enough. In part (4) Budget, we asked this control structure in detail as follows:

- a. Is there a rigorous preparation of estimated budgets and an estimated income statement each year?
- b. Is the system of development of the budgets and their control system the same one as that of head office?
- c. The indicator are value only, or also in quantities and quality?
- d. How are decided new investments? At the level of the subsidiary or at the head office? How?
- e. How do you decide on the new equipment investment? Do you decide on it based on the same investment analysis model as headquarter?

Through these questions, we want to clarify the control systems on which Japanese headquarters depend for high financial performance. As the constitution of interview shows, two aspects are important. To control performance, it is necessary to pay attention to both human factor and performance evaluation. These two factors become effective management tools for high performance. And also, excellent human resource management is a cause of high financial performance. Excellent performance evaluation system is a cause of high financial performance. High financial performance is the effect of this excellent human resource management and performance evaluation system. High performance companies deploy these excellent human resource and performance evaluation system bilaterally. This can be shown as follows:



Figure2. Relationship between Control system and financial performance

In this paper, research focus is on the performance evaluation system for control. In relation to this, I will show the performance evaluation systems of Japanese subsidiaries. Particularly I emphasize the performance evaluation measures which include financial and nonfinancial ones. Recently, not only financial measures but nonfinancial measures are regarded as important for continuous growth. It seems that traditionally Japanese firms accept these measures as important. This is one remarkable attribute of Japanese management.

As interview results, I summarize some elements of 7 subsidiaries in Indonesia like this table.1.

	Share of capital by Japanese headquarter	Industry	Financial measure	Nonfinancial measure
S1	60%	Service	No answer	No answer
S2	85%	Manufacturing	Operating profit rate	Spoilage rate, Delivery, claims
S3	95%	Logistics	Net Profit After Tax	Safety, Compliance
S4	100%	Manufacturing	ROA	Inventory, Loan, Financing
S5	66%	Manufacturing	Dividend	No answer
S6	90%	Manufacturing	Profit rate	No answer
S7	83.4%	Manufacturing	Operating profit, Contribution margin etc.	KPI(Key Performance Indicator), Inventory level

Table 1. Summary of performance measures in subsidiaries

As financial measures of this Table 1 show, Japanese subsidiaries are responsible for profit mainly. This means that many Japanese subsidiaries are authorized as profit centers. In addition, these subsidiaries must pay attention to nonfinancial factors, too. These characteristics in Japanese subsidiary will be considered in the next section.

5. Discussion

As previous section shows, Japanese subsidiary is organized as local profit center in the world network of corporate group. And also, these subsidiaries can't decide on large scale manufacturing investment. Headquarter has a great authority over subsidiary on it. In the case of Japanese subsidiary, headquarter shares high percentage of capital. Due to this, it has a huge controllability on foreign subsidiary. Japanese subsidiary can require not only attainment of high financial performance but also nonfinancial performance to local subsidiary. At the same time, headquarter delegate many expatriates in accordance with business issues which must be solved in the subsidiary.

In addition to management control, Japanese subsidiary is eager in social contribution activity and human development activity of lower employees. This is an interesting characteristic of Japanese subsidiary. This characteristic can contribute to effective management control indirectly. For example, scholarship is offered for young student in local country. Family day for employees is held in subsidiary site and short trip for employees is provided. Also, employee can study Japanese language free. They have an opportunity to study business in Japan, too. These are fringe benefits for employees in Japanese subsidiary.

This management control relationship between headquarter and subsidiary in Indonesia can be shown as this figure 3.

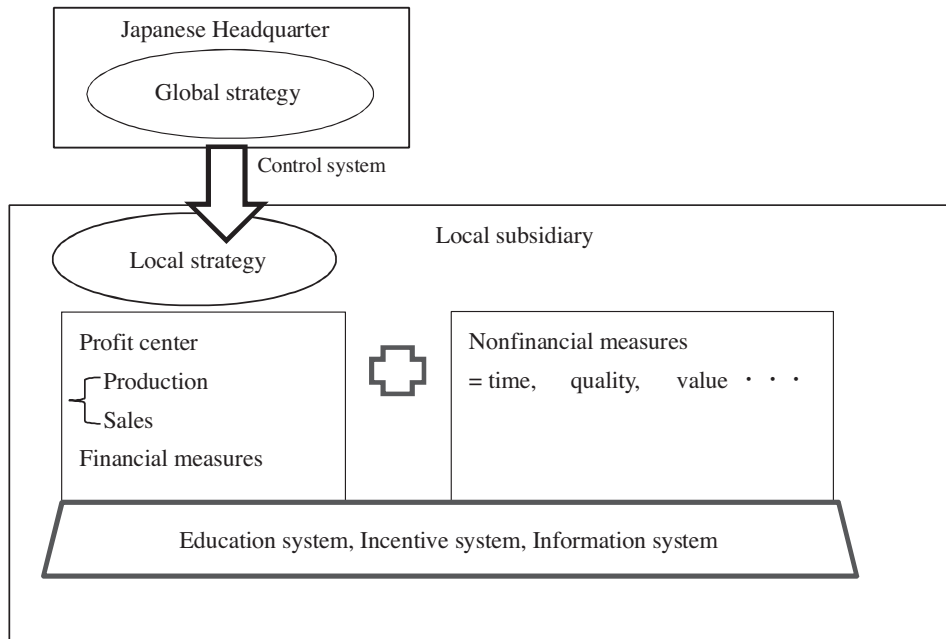


Figure 3. Subsidiary Control relationship of Japanese MNCs in Indonesia

This control system consists of two elements, financial measures and nonfinancial measures. Financial measures are effective with nonfinancial measures because these nonfinancial measures are the cause of financial results. For example, high quality brings customer reputation. High quality is competitive advantage. As a result, Japanese headquarter require not only effect but also cause to the subsidiary at the same time.

To make this control system effective, infrastructure is necessary. This infrastructure includes education system, incentive system, information system and so on. This infrastructure plays an important role for employee. Owing to these systems, most of the employees want to stay there at work. Infrastructure underlies management control system for performance evaluation of subsidiary. Japanese MNCs are apt to emphasize this infrastructure in Figure 3.

6. Conclusion

In this paper, I show the essence of management control systems in Japanese MNCs. Mainly Japanese subsidiaries disperse into Asian countries. Manufacturing subsidiaries are located in not only China but Asian emerging countries rapidly. I visited 7 Indonesian subsidiaries and implemented interviews with top management in subsidiaries. This paper is a result of qualitative analysis on these interviews. To show this result as basic control relationship between headquarter and subsidiary, I build management control relationship model of Japanese MNCs in Indonesia.

Indonesia is very attractive location for Japanese MNCs. This management control model suggests important control systems of subsidiaries in emerging countries. I'm sure that these Japanese subsidiaries

can contribute to economic development in Indonesia greatly for the future.

This study shows many critical issues for the future. But I prepared management control model based on only 7 interviews. Very narrow industrial park was visited for the research. I must visit more subsidiaries in other countries extensively. This is necessary to build general management control model of MNCs subsidiary.

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Notes

- 1) Anthony, R.N. and G. A. Welsch(1981);p.421.
- 2) Professor Shuji Mizoguchi and Professor Masaru Takahashi in Yokohama National University.

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