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INTERNATIONALIZATION AND MANAGEMENT CONTROL: THE CASE OF A MULTINATIONAL CORPORATION

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ABSTRACT

L'avvento della globalizzazione ha comportato l'inizio di una nuova era, caratterizzata da cambiamenti e sviluppo tecnologico che hanno drasticamente cambiato la vita delle persone e, in particolar modo, le dinamiche del business. Infatti, il contesto economico e il mondo degli affari sono stati rivoluzionati dalla nuova necessità delle aziende di internazionalizzare la loro attività in modo tale da aumentare la loro impronta – nonché la loro base di clienti – nel mercato internazionale.

L'obiettivo di questa tesi consiste quindi nel capire quali siano le ragioni dietro la nascita e l'evoluzione delle imprese multinazionali in seguito al fenomeno globale dell'internazionalizzazione, e più specificatamente, come tali strutture complesse siano in grado di gestire con successo le attività giornaliere tramite l'aiuto dei sistemi di pianificazione, controllo e misurazione dei risultati.

Entrando nei dettagli, il primo capitolo sarà focalizzato sulla storia delle imprese multinazionali, come queste si sono evolute e come sono strutturate; un'attenzione particolare verrà infatti posta sulle prime forme di struttura organizzativa – a partire da quelle funzionali, divisionali e a matrice – e a come sono progredite fino ad oggi – a quelle basate sul team work e sulla creazione di una rete (network). In seguito, verranno esaminati i fattori che spingono le imprese ad internazionalizzare ed in particolar modo le motivazioni reattive e quelle proattive; di conseguenza, sarà possibile capire quali sono i benefit tangibili dell'espansione globale. Successivamente, verrà prestata una particolare attenzione sulla costituzione e costruzione di un linguaggio comune di gruppo, il quale risulta fondamentale nelle imprese multinazionali per superare le incomprensioni e creare invece un senso di appartenenza e coesione all'interno dell'impresa stessa.

Questo porterà al secondo capitolo, che sarà focalizzato sulla strutturazione e organizzazione dei sistemi di pianificazione e controllo. L'ammontare dei benefici

portati da una gestione profittevole dell'impresa multinazionale, sarà difatti ottenibile solamente con l'istituzione di un efficiente sistema integrato nell'intera struttura organizzativa. Questa parte dell'elaborato sarà più specifica ed andrà ad analizzare in primo luogo il processo di gestione strategica e in secondo luogo il processo del controllo di gestione. Nel corso del capitolo sarà possibile capire come questi due processi siano strettamente correlati e come le decisioni prese in uno dei due andranno ad influenzare i risultati dell'altro. Per quanto riguarda il processo di gestione strategica, l'enfasi maggiore sarà data sul trade-off adattamento locale e integrazione globale, ovvero nell'approccio adottato dalle imprese per competere sul mercato e che può riguardare la localizzazione delle attività dell'azienda in termini geografici (quindi localizzare le attività in un solo paese o in più paesi) oppure il modo in cui le attività sono localizzate e coordinate fra loro (quindi centralizzare o decentralizzare l'attività del management).

Sulla base dell'approccio intrapreso, il management deciderà di conseguenza quale strategia perseguire in termini di ingresso sul mercato. Per quanto riguarda invece il processo del controllo di gestione, l'attenzione sarà rivolta sulla distinzione fra controllo amministrativo, sostanziale e sociale (o culturale). Si vedrà, infatti, che le imprese multinazionali riusciranno a soddisfare i requisiti di coordinamento che tipicamente ostacolano l'ambiente di un'azienda internazionalizzata solamente adottando in modo efficiente le tre tipologie di controllo. Ad ogni modo, le attività su cui verrà posta maggiore attenzione sono quelle riguardanti il controllo amministrativo, ovvero quella tipologia di controllo che richiede l'utilizzo di meccanismi tradizionali come sistemi di pianificazione, analisi di investimento, costruzione del budget, del reporting e della misurazione delle performance, che permettono al management di collegare piani, programmi, politiche e decisioni per l'analisi e il bilanciamento fra i vantaggi competitivi globali e le peculiarità locali. Il secondo capitolo si conclude poi con la spiegazione del ruolo del team *"Financial Plannning & Analysis"*, o FP&A, un'attività di

recente implementazione e diventata necessaria nelle imprese multinazionali in quanto responsabile per tutte le attività di pianificazione e reportistica a livello corporate, e il cui obiettivo è quello di garantire conformità rispetto alle disposizioni interne, nonché integrità contabile agli occhi dei maggiori portatori di interesse.

Quest'ultima spiegazione condurrà poi al capitolo finale della tesi, ovvero quello riguardante il case study. Il caso prevedrà una breve introduzione dell'azienda sotto analisi e la sua evoluzione da piccola impresa a conduzione familiare ad unità operativa di una multinazionale; la struttura organizzativa verrà poi esposta tramite una configurazione dell'organigramma aziendale. Successivamente, l'analisi si focalizzerà sulle attività principali dell'ufficio *Finance,* in particolar modo, saranno studiate le attività di *Cash Pooling* e *Financial Reporting.*

L'attività del *Cash Pooling* come strumento di controllo della liquidità globale verrà inizialmente definita e spiegata, per poi essere applicata al caso; infatti, verrà analizzata soprattutto la tecnica dello *Zero Balance,* ovvero la tipologia imposta dall'azienda casa madre e adottata dall'unità operativa in riferimento, nonché tutti gli strumenti che sono dietro all'applicazione della stessa.

L'attività del *Financial Reporting*, d'altro canto, prevedrà lo studio di tutti quegli strumenti di reportistica che sono imposti dalla casa madre e che caratterizzano l'attività dell'FP&A, quali gli strumenti di previsione, la revisione mensile del bilancio e le attestazioni trimestrali di conformità rispetto alle disposizioni interne – necessari per la società madre affinché possa monitorare efficacemente l'andamento delle unità organizzative locate in tutto il mondo.

Si dimostrerà, quindi, che l'implementazione di un sistema efficace di pianificazione, controllo e monitoraggio delle performance permette all'impresa multinazionale di assicurarsi che la performance finale sia in linea con gli standard e gli obiettivi strategici stabiliti dal corporate.

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INTRODUCTION

The aim of this paper is to understand the reasons behind the birth and the evolution of multinational companies following the global phenomenon of internationalization, and specifically how such complex structures are able to succesfully manage their daily activities with the help of planning, control and measuring systems. The first chapter will be then focused on the history of multinational corporations, how they developed through years and how they were organized; here, a particular attention will be given to the first forms of organizational structure as well as their progression till nowadays. Afterwards, the determinants for going international will be examined, which will allow to understand what the material benefits from global market expansion are. Subsequently, an additional emphasis will be given to the built of a corporate common language, which results fundamental in globalized companies to overcoming misunderstandings and creating, instead, a sense of belonging and cohesion within the firm. This will lead to the second chapter, where the focus will be given to the structuring and management of planning and control systems. The amount of benefits brought about by the profitable management of a company competing in international markets, will indeed only be obtainable with the institution of an efficient integrated system far and near the organizational structure. This part of the paper will be more specific, and it will deeply analyze the strategic management process in the first place, and the management control process in the second place. Throughout the chapter, it will be possible to understand how these two procedures are strictly connected and how the decisions taken in one of the two will influence the results of the other. For the strategic management process, the globalization versus national responsiveness conflict will be analyzed more in-depth, while regarding the management control process the focus will mainly be on

the difference between output, process and social control. In addition, another focal point of this chapter is given by the reporting activity – which is part of the output control – due to its crucial role of corporate communication tool in complex organizations such as multinational companies. What is more, this paper will briefly describe who is the main responsible for the elaboration of such reporting activity, or rather the role of the financial planning and analysis team, a recent job position widespread especially in multinational corporations or complex organizations, where this task turns out to be fundamental for the fulfillment of ordinary corporate activities. This latter explanation will, at last, lead to the final chapter of the paper, the case study. Here, the Italian firm "Avery Dennison RIS Italia SRL", subsidiary of the American multinational corporation "Avery Dennison Co." will be put under analysis. The study will firstly start from the understanding of the corporate organizational structure; after that, the main activities of the Finance department related to what the corporate imposes to its business units will be explored and interpreted. In particular, an initial look will be given to the cash pooling activity as a tool for managing and monitoring global liquidity but also to simplify bank account structures. Notwithstanding, the reporting activity will represent the core of the analysis; in this final part of the paper, in fact, three main activities of the financial planning and analysis team are observed: the forecasting tools, the balance sheet review and the quarterly attestations. Once the analysis has been completed, the relative final conclusions will be outlined.

CHAPTER 1
INTERNATIONALIZATION:
THE ROLE OF MULTINATIONAL COMPANIES

The advent of Globalization has entailed the beginning of a new era, an era of significant developments which drastically changed the life of population and, above all, the dynamics of business. Indeed, the business environment has been revolutionized by the need of companies to internationalize their activity in order to increase their footprint or client base in the international market.

1.1 The evolution of multinational corporations

"A multinational corporation is a business organization whose activities are located in more than two countries".[1] These companies are incorporated in a country, i.e. central head office or parent company, and they operate worldwide through the establishment of branches or subsidiaries in foreign countries. They are commonly engaged with the production or sale of goods and services across borders; in any case, these activities are always operated and controlled by the parent company.

In economic terms, the adoption of a multinational corporation may be considered as a form of foreign direct investment. This business typology involves operating production or distribution systems abroad by way of a wholly (or majority) owned affiliate – a joint venture, or a strategic alliance – where the main focus is "the ability of owners and their managerial agent in one country to control the operations in foreign countries".[2] However, it is relevant to consider that there

[1] B. Kogut, Multinational corporation, *International Encyclopedia of the Social & Behavioral Sciences*, Oxford: Pergamon, 2001, pp. 10197.
[2] B. Kogut, *cit. op.,* pp. 10197. The central aspect of "direct investment" is the ownership claim by a party located in one country on the operations of a foreign firm or subsidiary in another. The

is also a sociological definition about multinational companies. Indeed, due to their worldwide nature, multinational corporations represent the mechanism by which organizational knowledge and practices are transferred and replicated from one country to another.[3]

To understand the main reasons of the increasing diffusion of multinational corporations throughout the world, it is important to start from their beginnings. At first, due to the difficulty of transacting across borders, the multinational company finds its roots since the origins of trade in and between cultural communities, thanks to its ability to organize transactions within its own organizational boundaries. Hence, fairs, partnerships as well as the birth of the first companies represented the primary trade tools. It was not until the end of the nineteenth century and early twentieth century, however, that massive foreign investments were encouraged by the increasing wealth of western countries, which further on led to the birth of the first form of investment company, particularly well-known in British colonies: the "free-standing" company, as labelled by Wilkins in 1988. The functioning of this firm consisted in raising capital in the domestic financial market where its administrative office was located but without operating any domestic activities, in fact, all operations were overseas. This typology of company was considered by many as the representation of "the advantage of western countries in being able to raise capital from efficient financial markets". [4] Similarly to the British case, the direct investment strategy was adopted by American firms in an expanding military presence of the home government. Due to poverty conditions of countries like the Caribbean, Mexico and Central America, and South America in fact, the first forms of multinational corporations immediately responded to the demands of the host nation to provide public services – such as hospitals, roads and power – through

multinational corporation, thus, is the product of foreign direct investment that is defined as the effective control of operations in a country by foreign owners.

[3] B. Kogut, *cit. op.,* pp. 10197

[4] B. Kogut, *cit. op.,* pp. 10198

concessionary contracts.[5] With this regard, the multinational corporation usually evolved in the context of specific national institutions which accompanied the oversea expansion of the multinational with a co-investment. This was basically an expansion strategy through which multinational companies stepped into the project between the two governmental agencies and imposed their own rules for the pre-qualification and the tendering process of the project.[6] "History repeats itself", indeed this pattern can be seen in American investments in the United Kingdom during the 1950s and also, it was replicated by Japanese multinational corporations investing in the United Kingdom in the 1980s and in the 1990s.[7]

The history behind the birth of multinational corporations in each country has then influenced the organizational structure through which they developed their business activity. Indeed, the organizational structure is a representation of the overall pattern of components and configurations used by the company management to organize and coordinate business functions, with the aim to achieve corporate goals. According to business historian Alfred Chandler, there are two "critical transformations" which led to what we consider as a modern corporation: Line-and-Staff Structure and the Multidivisional Corporation. The Line-and-Staff structure was firstly adopted by the railroad companies of the US, "where employees were either *line*, allocated to operational tasks within the operating units, or *staff*, administrators and functional specialists located at head office".[8] By the end of late Nineteenth century, Line-and-Staff structures evolved, becoming the first forms of "functional structures" characterized by "separate operating units with large functional departments that conducted functions such as sales, finance,

[5] R. D. Robinson, *International Business Policy*, Holt, Rinehart and Winston, 1964
[6] Q. G. Seriña, An overview of the legal aspects of concession agreements in Latin America, *ILSA Journal of International & Comparative Law*, 1999, Vol. 5 – pp. 371.
[7] J. Dunning, The governance of Japanese and US manufacturing affiliates in the UK: Some country-specific differences. In: B. Kogut, *Country Competitiveness: Technology and the Organizing of Work*, Oxford University Press, 1993.
[8] R. M. Grant, *Contemporary Strategy Analysis*, Blackwell publishing Ltd, UK, 2008, pp. 173.

research and development, legal affairs, and other specialist activities".[9] At the same time, other large enterprises assumed the form of "holding companies" consequently to a series of acquisitions under the form of direct investment.[10] As regards to the multidivisional corporation, it emerged during the 1920s and it slowly replaced both the centralized, functional structures and the holding companies created in the aforementioned merger wave of the early Nineteenth century.

The configurations of early American and European firms serve as evidence: on the one hand, young American multinational corporations started their oversea activities within the existing organizational structures (which could be functional or divisional); as foreign sales increased, the necessity to have international "area" or "product" divisions accountable for managing sales and providing customer support directly on place, arose. At this point, the refinement of "organizational technologies" allowed American firms "to manage their rapidly growing operations on a worldwide basis"[11]. On the other hand, European firms were marked out by political and economic turmoil, as a consequence, their organizational structures were most of the times considered inefficient compared to American multinational companies. What is more, European most spread firm structure was the "holding company", followed by "banks and other financial institutions" – which played powerful roles in ownership and cross holdings – these structures were characterized by a mother-daughter relationship consisted of "a headquarter that held a portfolio consisting of ownership control over dozens of companies, many of them in the same sector but located in different countries".[12] In essence, these different organizational structures are proof of how companies approaching the mid-twentieth century needed adaptability and flexibility to face the upcoming

[9] R. M. Grant, *cit. op.,* pp. 173.
[10] With this regard, the parent company bought controlling equity stake in a significant number of other companies.
[11] B. Kogut, *cit. op.,* pp. 10199.
[12] B. Kogut, *cit. op.,* pp. 10200.

globalized and integrated environment. Here comes the necessity for an appropriate design of the organizational structure, fundamental to match the strategy of an entity with its relative business environment.

Organizational designs are crucial to establish reporting and authority relationships, formal communication channels, the ways in which the diverse functions of individuals are actually linked together, and also the control mechanisms which better fit company's needs. The "building blocks" at the basis for the elaboration of an organizational structure are centralization, formalization, hierarchical levels, and departmentalization.[13] They represent the starting point in structure configuration because:

- *centralization* explains the degree to which decision-making authority is concentrated at higher levels in an organization;
- *formalization* depicts the extent to which an organization's policies, procedures, job descriptions and rules are written and explicitly articulated;
- *hierarchical levels* show the number of levels that a company's structure has in its hierarchy. It can be differentiated among "tall structures" where there are several layers of management between frontline employees and the top level, and "flat structures" where layers of management are less;
- *departmentalization* represents the categorization of companies' structures between "functional structure" (Figure 1.1, tasks are divided on the basis of the similarity of their functions – e.g. organized by production and sales) or "divisional structure" (Figure 1.2, departments represent the unique products, services, customers or geographic locations the company is serving, each product or service has its own

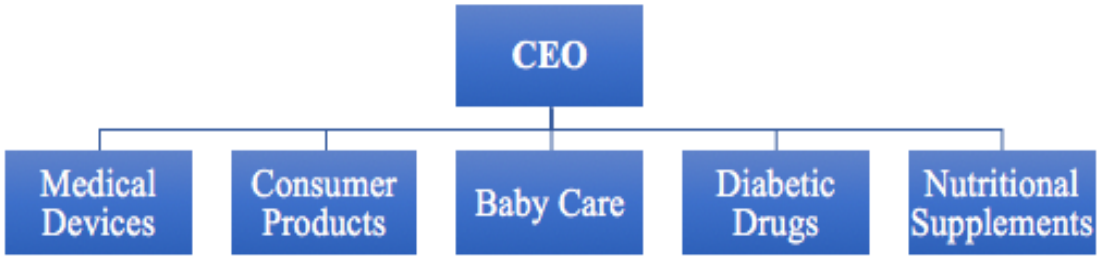
[13] M. Carpenter, T. Bauer and B. Erdogan, *Management principles*, Flat World Knowledge Inc., 2009, Chapter 7.

department and within each department, functions such as marketing, finance or manufacturing are replicated – e.g. organized by geographic area or product division).

Figure 1.1 - Example of a functional structure at a pharmaceutical company

Adapted from M. Carpenter, T. Bauer and B. Erdogan, *Management principles*, Flat World Knowledge Inc., 2009, Chapter 7.

Figure 1.2 - Example of a divisional structure at a pharmaceutical company



Adapted from M. Carpenter, T. Bauer and B. Erdogan, *Management principles*, Flat World Knowledge Inc., 2009, Chapter 7.

On the basis of the arrangement of these building blocks, two different configurations of organizational structures may be found: the "mechanistic

structure" and the "organic structure". The *mechanistic structure* may be compared to a bureaucracy, that is a system of administration based on specialization (systematic division of labor), hierarchical structure, coordination and control, standardized rules and norms, and so on. In other words, a formalized and centralized structure where communication follows only formal channels and the employees are assigned to specific jobs with specific descriptions of their roles and responsibilities. The *organic structure*, on the contrary, is less formal, more flexible and what is more, it envisages coordination based on mutual adjustment. The latter is particularly useful in business environments that are unstable and uncertain because of its ability to adapt to the specific needs of the organization directly on time; the former, is typical of stable environments, in which it reveals to be very efficient.

Therefore, the choice of the organizational structure represents a critical issue for companies, especially in the current tumultuous environment. Generally, the main focus is "to reorganize hierarchies in order to increase responsiveness to external change"[14], here derives the organizational changes of some of the biggest multinational corporations who retained the basic multidivisional structures, but "reduced the number of hierarchical layers, decentralized decision-making, shrunk headquarters staffs, emphasized horizontal communication, and shifted the emphasis of control from supervision to accountability".[15] For this reason, multinational companies have to struggle with the problem of choosing the right hierarchical structure and deal whether with product divisions, country subsidiaries or functional departments. In order to clarify the organization of more complex corporations, here are some of the principal bases for grouping employees and resources:

- *tasks,* common tasks may be grouped together;

[14] R. M. Grant, *cit. op.,* pp. 183.
[15] R. Whittington and A. Pettigrew, New Notions of Organizational Fit, *Financial Times*, Mastering Strategy, Part 10, 1999, pp. 8-10. In: R. M. Grant, *cit. op*., pp. 183.

- *products,* for companies who offer multiple products the structure may be divided per each product;
- *geography,* business units may be organized by area or region;
- *process,* the organization may be divided in set of processes.

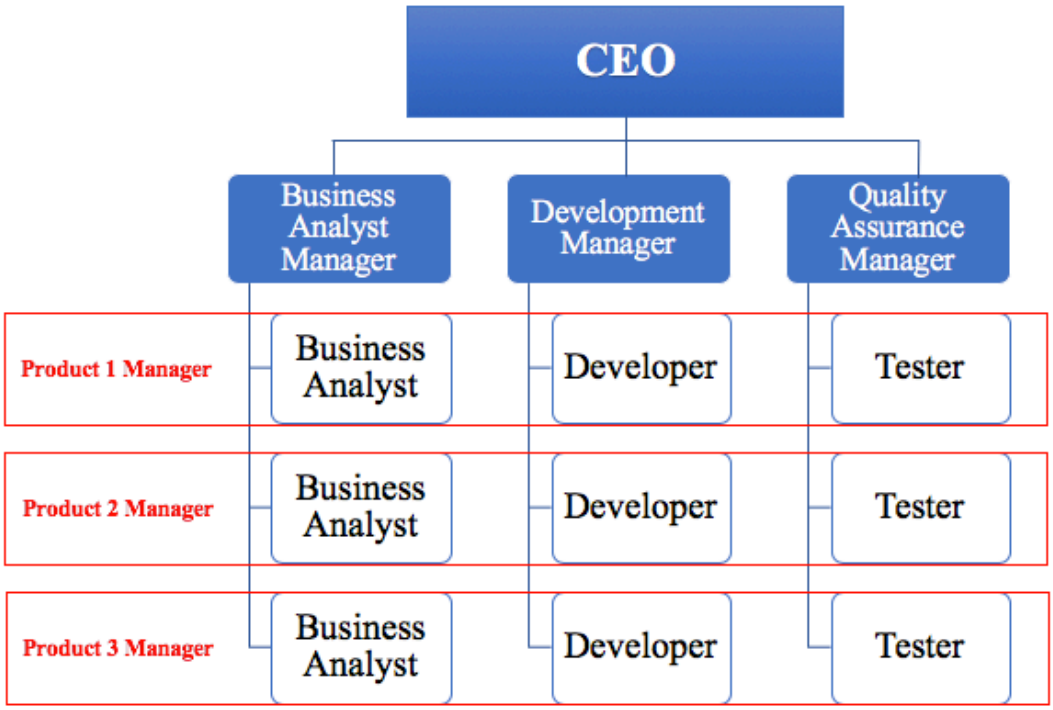
In parallel with the choice of the hierarchical structure, the achievement of coordination to integrate the efforts of different individuals is also a matter of relevance at this stage. Subsequently, it is important to create hierarchical control across the structure in order to allow an effective coordination. With this regard, organizations should consider the "principle of hierarchical decomposition" as named by Oliver Williamson, according to which "the hierarchical decomposition principle can be stated as follows: internal organization should be designated in such a way as to effect quasi-independence between the parts, the high frequency dynamics (operating activities) and low frequency dynamics (strategic planning) should be clearly distinguished, and incentives should be aligned within and between components so as to promote both local and global effectiveness".[16] In other words, there should be a clear distinction between operating level and strategic level, so that an operational autonomy to subordinate units is given but at the same there is a separate organization unit which exercises coordination and direction.

However, due to the current business environment other forms of organizational structure emerged. On the one hand, a mix of the previous mentioned designs represented the innovation at the beginning of the 1970s, on the other hand, globalization and technological change proclaimed "the death of hierarchical structures in business firms".[17] Matrix organization is the combination of traditional functional structure with product structure and it aims at gaining benefits

[16] O. E. Williamson, The Modern Corporation: Origins, Evolutions, Attributes, *Journal of Economic Literature*, 19/1981, pp. 1537-1568. In: R. M. Grant, *cit. op.,* pp. 185.
[17] R. Daft, A. Lewin, Where are the theories for the new organizational forms*, Organization Science*, 3/1993, pp. 1-6. In R. M. Grant, *cit. op*., pp. 190.

from both of them; this structure was typical of multinational corporations because of their multiple products, functions and locations. To make an example, employees report to department managers, but they can also be pooled together to participate at projects or product teams, as a result, each employee will report to a department manager as well as a project or product manager. Product managers will be accountable for product-related matters, while department managers will have authority over matters related to company policy as shown in Figure 1.3.

Figure 1.3 - Example of a matrix structure at a software development company



Adapted from M. Carpenter, T. Bauer and B. Erdogan, *Management principles*, Flat World Knowledge Inc., 2009, Chapter 7.

In contrast, the new business environment claimed for "flatter hierarchies, decentralized decision making, greater tolerance for ambiguity, permeable internal and external boundaries, empowerment of employees, capacity of renewal, self-organizing units, self-integrating coordination mechanisms"[18]; as a consequence, hierarchical layers have been removed, mechanistic formality has been replaced by organic informality, and alternative forms of organizational structures emerged. Although these organizational forms still include some hierarchical elements, they are distinctive enough to be considered as "alternative organizational forms".[19] They distinguish from the traditional and modern organizational forms thanks to the focus on coordination rather than control, the capacity of coordination through mutual adjustment rather than hierarchy, and the ability of individuals of switching their organizational roles and occupying multiple roles simultaneously. These are:

- *adhocracies,* named by Henry Mintzberg, which feature flexible, spontaneous coordination and collaboration around problem solving and other nonroutine activities (these are typical of research organizations, new product development groups and consulting firms);
- *team-based and project-based organizations,* which consist in the continuous reorganization of the structure each time a new project comes in. They are characterized by flexibility and adaptability, consequently they employ people with mutual adjustment and problem-solving skills (these are common in sectors such as construction, consulting, oil exploration and engineering services);
- *networks,* which consists of localized networks of small, closely interdependent firms that often feature a central firm that acts as a "system integrator".[20] In fast-moving industries, the ability of highly specialized,

[18] R. Daft and A. Lewin, *cit. op.*
[19] R. M. Grant, *cit. op.,* pp. 191.
[20] G. Lorenzoni and C. Baden-Fuller, Creating a strategic center to manage a web of partners, *California Management Review* 37, no. 3, pp. 146-163, 1995.

know-how intensive firms to reconfigure their relationships can be conducive to innovation, product differentiation, and rapid new product development[21] (these are typical of clothing industries, packaging equipment, Hollywood movie making and microelectronics in Silicon Valley).

Most of these structures are implemented because of the need for the company to have an organizational change, that is "the movement of an organization from one state of affairs to another".[22] Organizational change may indeed affect a company's structure, strategy, policies, procedures, technology, or culture; as a consequence, it requires people who are flexible and adaptable by nature to the new priorities of the firm. The change that the company has to face may have been planned or it might be necessary (sometimes even forced) due to environmental changing factors – especially for firms operating in the technology field. Also, it may be a radical change and rapidly alter the way in which the company operates, or it may be incremental and slow. In any case, organizational change implies an abandon of the ways in which the corporation has worked until that moment and the relative adjustment to the new necessities. However, there are techniques which may be implemented in order to better facilitate the changes; one of them in particular, consists of three steps: the first one "the unfreeze" whose aim is to ensure that employees are ready for change, the second one "the change" with the aim of executing the intended change, and finally "the refreeze" whose aim is to ensure that the change becomes permanent among employees.[23] Nevertheless, in the current environment where globalization and fastness of innovation are protagonist, the change must be considered as a continuous process – especially by multinational corporations who are influenced by vicissitudes from all over the world. This leads

[21] R. M. Grant, *cit. op.,* pp. 191.
[22] M. Carpenter, T. Bauer and B. Erdogan, *cit.op.*
[23] The "K. Lewin's three-stage process of change" was developed in 1950 and it is one of the most useful frameworks in the area of planning and executing change effectively.

to the need for an additional form of organizational structure, the *learning organization.* Here, the main aim is to "actively seek to acquire knowledge and change behavior as a result of the newly acquired knowledge"[24], learning becomes then a regular part of daily operations. Experimenting, learning new concepts, reflecting on new features, testing potentially better operational methods, these are all methodologies adopted by learning organizations to embrace continuous change. In these company structures failure is tolerated and risk taking is encouraged, because in case of failure, learning organizations can really learn from past experience (whether it is the company's experience or a competitor's one) and do their best to work even better. In such environments, hence, people are the means to respond to the surrounding possible threats but also to identify new future opportunities.

1.2 The determinants of going international

From time to time, companies look for opportunities around the world in search of profitable new markets, outsourcing facilities, acquisitions, and alliances.[25] They must be able to quickly adapt their policies to face and exploit new global market challenges and opportunities. In order to do that, manager must be ready to understand the political and economic choices facing key nations and how these choices will affect the outcomes of their decisions. Research, indeed, has shown that firms of all sizes and in all industries that are engaged in international markets, report benefits from global market expansion. Such benefits may regard outperformance of the strictly domestic counterparts, growth in sales (more than twice), and significantly high returns on equity and assets.[26]

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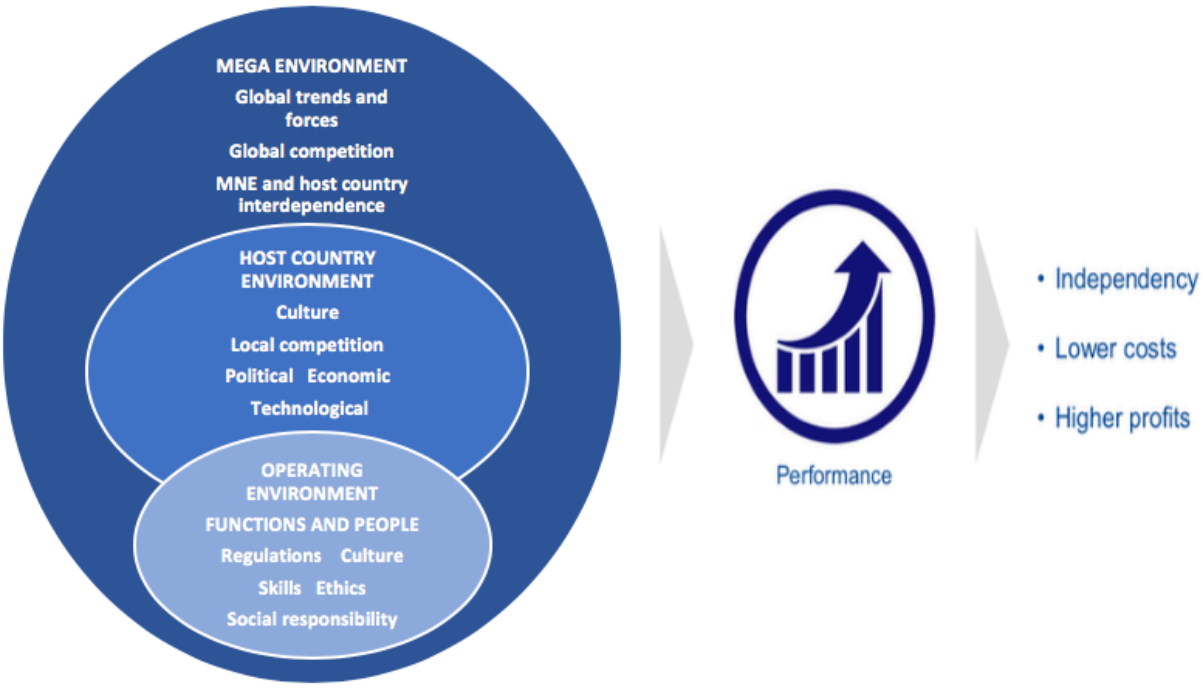
[24] M. Carpenter, T. Bauer and B. Erdogan, *cit.op.*
[25] H. Deresky, *International Management: Managing Across Borders and Cultures*, Pearson Education Inc., 2014, Chapter 6.
[26] M. R. Czinkota, M. Kotabe and I. A. Ronkainen, *The Future of Global Business: An International Marketing Manifesto*, Routledge, 2011, pp. 4.

Figure 1.4 - Benefits from global market expansion



Adapted from M. R. Czinkota, M. Kotabe, I. A. Ronkainen, *The Future of Global Business: An International Marketing Manifesto*, Routledge, 2011.

There are plenty of reasons why firms decide to expand their businesses overseas; some of them are reactive reasons (or defensive), others are proactive reasons (or aggressive).[27] Among the reactive reasons, the most relevant is global competition; companies who are left unchallenged in foreign markets become powerful and make it hard for other companies to enter at a later time, moreover, companies operating overseas will also be given a domestic advantage because of

[27] H. Deresky, *cit. op.*

the lower costs and market power gained in foreign markets. Trade barriers together with regulations and restrictions are also part of the reactive reasons. On the one hand, barriers such as tariffs, quotas, and other restrictive trade practices may favor overseas manufacturing due to the increased price of exporting; on the other hand, regulations and restrictions of producing in the home country may become so restrictive that it will be more convenient for companies to move abroad towards lower-tax countries. Another relevant reactive reason is given by customer demand, in fact, companies decide to operate overseas in response to customer demand or as a solution to logistical problems.[28] It is also common that some customers ask the company to operate in their local region, in this way they would have a higher control over supplies, and consequently they would force them to comply or lose the business. Among the proactive reasons, the possibility to seek economies of scale stands in the first place; in other words, the possibility "to achieve world-scale volume to make the fullest use of modern capital-intensive manufacturing equipment and to amortize staggering research and development costs when facing brief product life cycles" [29]. Resource access and cost savings probably represent the most common reason to go international. In particular, the availability of raw materials and other resources directly on place allows firms to have a greater control over inputs and lower transportation costs, in addition, lower labor costs (such as costs for production, service and technical personnel) guarantee lower unit costs and consequently lead to an increase in competitiveness both globally and in the domestic country. An additional reason to expand overseas may be found in the presence of incentives that the country offers to the host company; these incentives may include tools that are able to attract foreign companies by decreasing risk and increasing profits at the same time, such as tax exemptions, tax holidays, subsidies, loans, and the use of property. Last but not least, companies decide to operate

[28] H. Deresky, *cit. op.*
[29] A. K. Gupta and V. Govindarajan, *Managing Global Expansion: A Conceptual Framework*, Business Horizons, March/April 2000.

internationally also due to the presence of growth opportunities that are typical of a globalized world, in fact, an internationalized environment has much more to offer than one sole country.

Nevertheless, it is also relevant to consider that due to the situation of economic and political turmoil which led to the recent economic slowdown, many companies have been obliged to retrench rather than expand abroad. This latter one is considered as a strategy at all effects, especially in hard economic times. Corporate strategies, in fact, must adapt to and change in response to shifting global economic conditions together with other environmental and competitive factors.[30] It is because of this fast change that companies, especially Multinational Enterprises (MNEs), have recently engaged with the *strategic planning,* or rather "the process by which a firm's managers evaluate the future prospects of the firm and decide on appropriate strategies to achieve long-term objectives".[31]

1.3 The importance of building a group common language

Another aspect which results fundamental in managing an international firm is communication; indeed, "it is via language that executives in multinational corporations develop their strategies and policies, disseminate and implement them".[32] To make an example, activities such as spreading shared practices across the subsidiary network, introducing a new organizational structure with reporting lines, agreeing upon budgetary controls and submitting monthly reports, all require a great deal of consultation and discussion between headquarters and the subsidiaries.

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[30] H. Deresky, *cit. op.*
[31] H. Deresky, *cit. op.*
[32] Y. Luo and O. Shenkar, The multinational corporation as a multilingual community: language and organization in a global context*, Journal of International Business Studies*, pp. 325, 2006.

The multinational corporation has been recently conceptualized as a multilingual organization[33]; this means that, due to the fact that multinational companies usually consists of headquarters and subsidiary units which are geographically separated and most of the times embedded in different language environments, internal communication often involves crossing language boundaries and operating at the interface between several language: the corporate language and the "company speak" (without considering the presence of the languages of the home country and the host country).[34] Examples to facilitate in-house communication between units and to reduce language diversity may be found in the usage of English as main corporate language – companies often use abbreviations, expressions and a diverse vocabulary with respect to other firms – in board meetings, reporting, internal management meetings, management training and development, but also in inter-subsidiary communication (emails, for instance). This aspect is strongly supported by Y. Luo and O. Shenkar who specify that a common corporate language – which they call "parent functional language" – "is chosen to facilitate global coordination, streamline intra-network communication, and bolster transferability of information, knowledge and expertise".[35] In addition, it will allow managerial innovations collected from the units of the multinational network to be immediately identified, codified, and consequently ready to be adopted at corporate level. With this in mind, a common corporate language would bring an increase in efficiency derived by overcoming misunderstandings, reducing costs, avoiding time-consuming translations and creating a sense of belonging and cohesion within the firm.[36]

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[33] W. Barner-Rasmussen and I. Bjorkman, Language fluency, socialization and interunit relationships in Chinese and Finnish subsidiaries, *Management and Organizational Review*, pp. 105-128, 2007.
[34] R. Piekkari, *International management*. In Bargiela-Chiappini F., *The Handbook of Business Discourse*, Edinburgh, Edinburgh University Press, 2009, pp. 269-278.
[35] Y. Luo and O. Shenkar, *cit op.*
[36] R. Marschan-Piekkari, D. E. Welch and L. S. Welch, Adopting a common corporate language: IHRM implications, *International Journal of Human Resource Management*, pp. 377-390, 1999.

What is more, an effective communication between the parties involved must be built as a basis for the implementation of foreign subsidiary control. In other words, a common corporate language may be considered as a value-infused control mechanism to support and strengthen the corporate culture[37] as well as a mechanism for the headquarter to monitor its foreign operations. The establishment of a common corporate language in a multinational company represents a competitive advantage which will be able to increase the profitability of the internationalization process. One relevant aspect of multinational companies concerns the management of the various business units' finance offices; from this point of view, upper level managers have to deal with:

- different management accounting principles;
- different environmental conditions, such as inflation rates or volatility of exchange rates – which may make the comparison of economic results between countries and business units very complex;
- problems related to management accounting, such as different costing systems and profitability analysis – deriving from the fact that each country may have diverse business models, market and customer structure, and diverse cost of the inputs.[38]

This overall situation would lead to a real difficulty in the production of information at corporate level, and to an even more complex interpretation of them; that is the reason why without a common corporate language the entire cycle of planning and control would result ineffective.

In conclusion, the amount of benefits explained above, as well as the profitable management of an international company in general, will only be obtainable with

[37] Blazejewski S., *Transferring value-infused organizational practices in multinational companies: a conflict perspective.* In M. Geppert and M. Mayer, *Global, national and local practices in multinational corporations,* Basingstoke, Palgrave Macmillan, pp. 63-104, 2006.
[38] A. Dossi, Internazionalizzazione sotto controllo*, Economia e Management*, Egea spa, fasc. 5-6, pp. 28, 2016

the establishment and organization of *management and control systems* able to create an integrated system of national differences' exploitation, global economies of scale and international economies of scope.[39]

[39] A. Dossi, *cit. op.,* pp. 25, 2016.

CHAPTER 2
PLANNING AND CONTROL SYSTEMS IN MULTINATIONAL COMPANIES

In order to make the most of its potential, the internationalization process must be accompanied by a managerial development plan. A local general manager of trust is not enough; it is necessary to invest in the group's managerial mechanisms, and above all, in "planning, control and measure of performance systems". These systems must be designed and implemented according to the firm's specificities; in this way, the management will be able to take decisions according to economic rationality, and to evaluate the trade-off between global integration and national responsiveness.

The planning phase is the most delicate part because of the need to develop and implement a strategy which perfectly fits the company and whose aim is to fulfill its objectives. After that, the control procedures which will result from the strategy, will determine the accuracy of the strategy itself and will make sure that these are followed by managers. In fact, control systems are tools to monitor the trend of the company in a certain moment of time of its activity. This leads to the last phase, which is the one where the performances of the firm are measured and commented to verify that the objectives are correctly followed and whether they have been fulfilled or not.

The planning and control procedure culminates with the elaboration of the strategic budget and the relative reporting system, which in multinational corporations represents a moment where information from all over the functions, business units or divisions are collected, measured, compared to those of the previous year, and at the same time, the objectives for the future year are set.[40]

[40] A. Dossi, *cit. op.,* pp. 25, 2016.

2.1. Planning systems: the international strategies

The control process implies the set of activities through which the strategic objectives of a firm are determined, and whose fulfillment is guaranteed only by the conduct of the control process itself. Strategic planning is particularly relevant in this sense, due to its nature of company's activity where the main strategic priorities and business goals to pursue during the operational activity are identified.[41]

The strategic formulation process concerns a crucial phase of the corporate strategic management which needs to be done at the headquarters of the corporations as well as at each subsidiary. The planning phase primarily involves upper level managers, or rather those who have coordination powers, who detain more specific information and who have the authority to undertake innovative paths in a firm; however, it also involves lower level personnel, due to the fact that managers need to collect and use information from those who are responsible for the operating activity. In addition, managers at top level must be able to spread the strategic objectives of the company throughout the organization; only in this way they will make sure that business goals are actually understood, shared, and consequently achieved by all.

The strategy is usually determined on a long-term perspective; however, adjustments are always needed in order to adapt to the business environment in which the company operates, in fact, the strategic formulation process is continuous and intertwined, with data and results from earlier stages which provide information for the subsequent ones.[42] The strategic management process may be represented as in figure 2.1: the overall process is divided between two main phases, the Planning and the Implementation, which are divided themselves in further stages.

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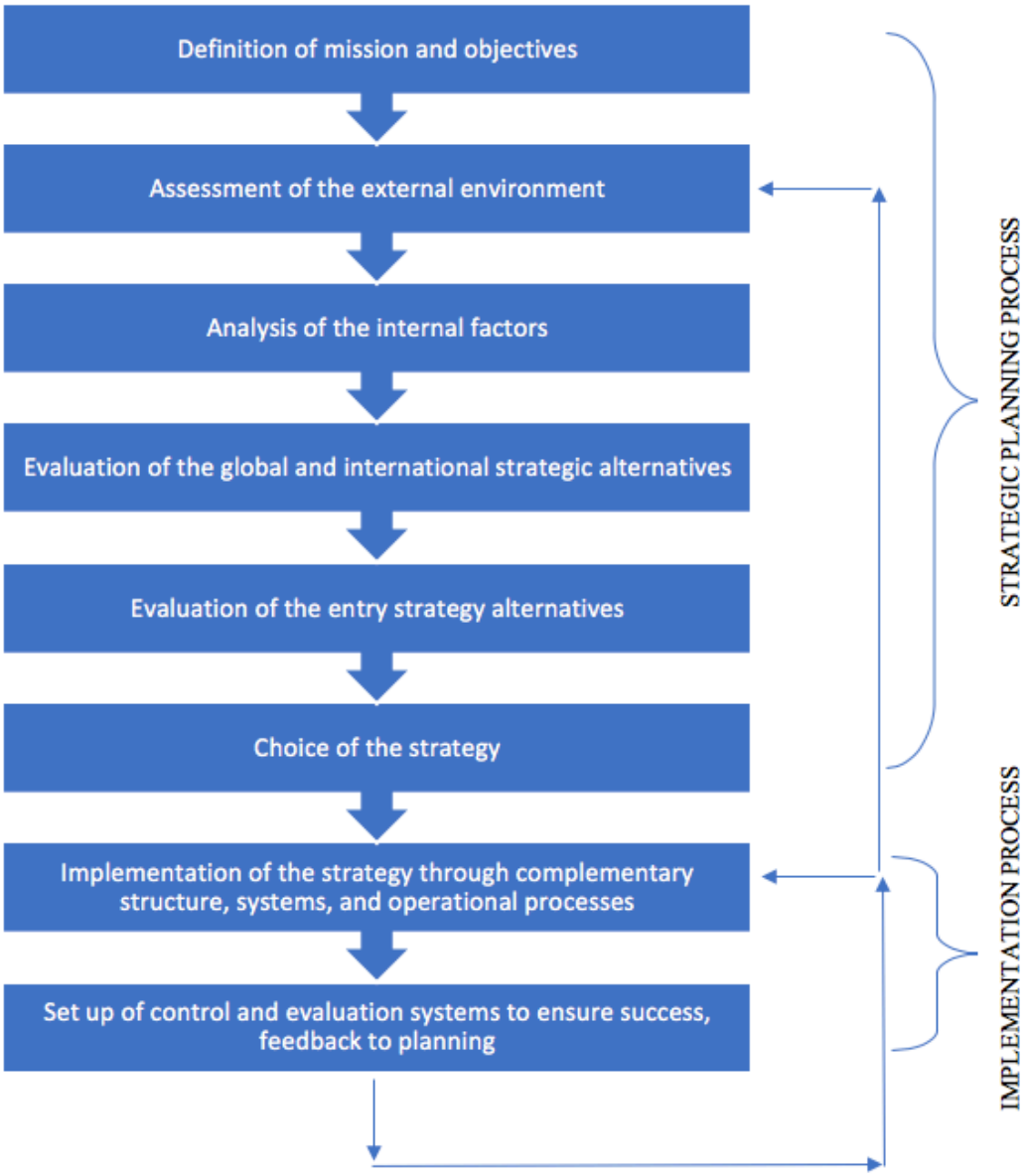
[41] A. Riccaboni, C. Busco and E. Giovannoni, *Il controllo di gestione. Metodi, strumenti ed esperienze*, Ipsoa, 3rd edition, Assago, 2014.
[42] H. Deresky, *cit. op.*

Figure 2.1 - The strategic management process



Adapted from H. Deresky, *International Management: Managing Across Borders and Cultures*, Pearson Education Inc., 2014, Chapter 6.

As per the first main phase, the strategic planning process, it is divided in six steps. First of all, the definition of mission and objectives of the company, or rather the function that it will perform in the society (the mission is, as a matter of fact, the *raison d'être* of a firm) and which provides a basis for strategic decision making – the objectives that the firm has to fulfill represent indeed a guide to the formulation of the international corporate strategy. Secondly, before going overseas, a company has to execute an environmental assessment (opportunities and threats), that is "the process of gathering information and forecasting relevant trends, competitive actions and circumstances that will affect operations in geographic areas of potential interest"[43]; in order to have a realistic vision of the environment, this activity has to be done at global, regional and national level[44]. The following step regards the analysis of the internal factors rather than the external ones; the internal analysis in fact, aims at determining the strengths and weaknesses, currently and potential, of the company with respect to its competitors. In other words, this step is about discovering what are the key success factors of the firm and how to take advantage of them to exploit foreign opportunities. To what it concerns the fourth step, this represents one of the most important ones: the evaluation of global and international strategic alternatives. In light of the competitive analysis, managers have to elaborate the resulting data and choose the one among the global and international strategic alternatives that better fit the company under analysis. There are two primary international strategies to enter world markets, they are considered primary because they represent the basis to elaborate a strategy overseas:

- Global strategy;

[43] H. Deresky, *cit. op.*
[44] Global risk examples: political turmoil/wars, economic and financial risk, currency wars, etc. Regional risk examples: economic and fiscal policies, financial and currency instability, etc. National risk examples: legal protection, technology rights, nationalism/expropriation, trade restrictions, corruption, repatriation policies.

- Multidomestic strategy (also known as Multilocal/Regionalization strategy).

The two strategies will be outlined later, in the following paragraph. Moving on with the following step, an evaluation of the entry strategies is necessary. The aim at this point is for managers to understand which strategy to enter the foreign market is more suitable, on the basis of the data collected until that moment (especially regarding the risks and the critical environmental factors associated with the strategies). Among the various entry strategies, the most popular ones are[45]:

- *exporting*, which concerns a relatively low-risk strategy to begin international expansion or to test an overseas market due to the little investment involved and fast withdrawal. Critical success factors are represented by the choice of distributors, transportation costs, and tariffs and quotas;
- *licensing*, which is also considered a low-risk strategy due to its need for a little investment; it grants the rights to a firm in the host country to produce or sell a product. Critical success factors are represented by the quality and trustworthiness of the licensee, and the host country royalty limits;
- *franchising*, which concerns a license of trademark, products and services, and operating principles from the franchisor to the franchisee, and which involves a relatively little investment and risk. The critical success factor in this case is the quality of the control of franchisee and franchise operations;
- *contract manufacturing,* that is a common practice to outsource cheaper labor overseas (it is also called *outsourcing*) and it consist of contracting the production of finished goods or component parts to external parties, of

[45] Adapted from H. Deresky, *cit. op.*

another country in this case. Also, in this case, there is little investment and risk, as well as short-term commitment; reliability and quality of local contractor together with operational control and human rights issues represent the critical success factors;

- *offshoring,* that is when a company moves one or all of its factories from the home country to the host country, avoiding trade barriers and overall lower cost of production. Risks and success factors are the same as in contract manufacturing;
- *service sector outsourcing*, which generally consists in outsourcing "white-collars" jobs overseas to reduce their overall costs; however, outsourcing "blue-collars" is considered too, it depends on the strategic aspects of the decision, made by the firm, which goes beyond immediate cost saving. It favors lower employment costs, but it demands for quality control as critical success factor;
- *turnkey operations,* which concerns the design and construction of a company's facility abroad; there, the company makes sure that local personnel are well trained in order to turn the key over to the local management – for a fee. It generally consists of a risky operation, however, if critical success factors – such as domestic client acceptance, reliable infrastructure, sufficient local supplies and labor, possibility to repatriate profits, reliability of any government partnership – are present, it reveals to be very profitable;
- *management contracts*, with this typology of strategy the foreign company is allowed to manage all the daily operations of a business, however, it cannot make decisions with regards to ownership, financing, or strategic and policy changes. It is considered as a short-term and a relatively low-risk operation; its critical success factor is to gain the opportunity to develop a longer-term position;

- *fully owned subsidiaries*, which consists in the total acquisition of an existing firm in the host country in order to have the full control of the operations in that particular country. It is considered as a risky strategy, especially when the multinational company decides to establish a new wholly owned foreign manufacturing servicing, or service company, or subsidiary with products for the local market or targeted for the export. Critical success factors are represented by the ability to assess and control economic, political and currency risk, as well as the ability to get local acceptance, and the possibility to repatriate profits;
- *international joint ventures*, that is a high-risk and high investment entry strategy. The typical joint venture involves an agreement between two or more companies to produce a product or provide a service together, the situation is different in the international joint venture, where the ownership between a multinational company and a local partner is shared through agreed-upon proportions of equity. The main aim of this strategy is to favor a rapid entry in the new market by means of an already established partner who already has contracts and familiarity with local partners and operations; also, international joint ventures are used to overcome trade barriers, to achieve significant economies of scale, to have access to additional raw materials, and so on. Critical success factors in this case are represented by the strategic fit and complementarity of partners, markets and products, the ability to protect the technology, the ability to share control, but also the cultural adaptability of partners.

As explained above, each one of the entry strategies has different advantages and critical success factors, the choice among them is competence of the sixth step, and it will depend on:

- an evaluation of the advantages and disadvantages of the strategy with respect to the firm's capabilities and resources;

- the critical environmental factors;
- the alignment of each strategy with the company's overall mission and objectives.

After that, timing entry and scheduling expansions are what managers will have to deliberate about before starting the implementation process – second (and last) main phase of the strategic management process.

As per the second phase of the process, it consists of two main steps.

First of all, the implementation of the strategy through complementary structure, systems, and operational processes. This is a delicate phase for the firm because of the importance of the right selection of the strategy and its implementation; the choice of strategic alliances, to make an example, reduces the risks of going alone in complex environments. In addition to that, companies, especially multinational corporations, should develop a plan of organization of the structure, as well as control and monitoring systems, which result fundamental for overseas operations. Finally, the role of the global human resources management becomes essential too; staffing, training and compensation for global operations, are all part of the implementation process and they require quite of attention.

Secondly, the setup of control and evaluation systems to ensure success, as well as feedback to planning. This last stage represents an occasion to monitor the trend of the overall process, consequently, it is a sort of starting point for the improvement of the process itself: if something appears to be wrong at this stage, it will be possible to go back to the previous ones such as the assessment of the external environment, but also to the step where the strategy has been implemented.

The planning process officially concludes with the elaboration of an "industrial plan", that is the document through which the overall activity of the previous mentioned phases takes the form, and which is taken as a reference point for the realization of the operational planning. The industrial plan is composed of two sections; a qualitative and a quantitative section. The qualitative section includes

the external environment analysis together with the internal environment of the firm.[46] The quantitative section includes the set of technical and organizational decisions illustrated in the qualitative section, with the addition of their translation in economic-financial terms[47]. The quantitative section is usually denominated "strategic budget", in fact, it consists of financial statements, cash flows, economic-financial analyses, key value driver trend, sensitivity analysis, and so on. The industrial plan, however, will only be put into operation through the definition of an effective control process.

2.1.1. Global integration versus national responsiveness

A firm operating in an international environment finds itself in a critical position when it comes to decide the structural choice that will design and compose its international strategy. By following the Porter's model of the value chain, it is possible to identify two main clusters of choices on which the management has to focus on and deliberate about.[48] The first set of alternatives regards the *configuration*, that is the localization of the activities of the firm in geographical terms. In this sense, the choice offers the possibility for the company to decide whether to locate its activities in one country or, on the contrary, to have activities all over the world. The second aspect to consider regards the *coordination*, that is the way in which the activities are located in the various countries and how they are connected and linked together. In this case, the options for the company are integration – centralized management of geographically dispersed activities – or

[46] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*
[47] This section contains the economic-financial analyses as well as the deriving results; through the elaboration of a financial statement, for instance, it is possible to determine the profitability of choices and actions undertaken, the impact on the organizational structure, the assets and liabilities position, and so on.
[48] A. Dossi, I sistemi di pianificazione e controllo nelle imprese multinazionali, *Sviluppo e organizzazione,* n. 142, pp. 69, 1994.

autonomy – local management of the activities, with the aim to take care of the needs of national markets.

The key decision behind these alternatives is whether the firm will pursue global or local strategies, and this is also commonly referred to as the "globalization vs. national responsiveness conflict".[49] On the one hand, *global integration* concerns "the production and distribution of products and services of a homogeneous type and quality on a worldwide basis"[50], which is typical of multinational corporations, who serve customers with homogenized tastes. On the other hand, *national responsiveness*, which consists in "the need to understand the different customer tastes in segmented regional markets and respond to different national standards and regulations imposed by autonomous governments and agencies"[51]; in addition to that, this strategy aims at adapting tools and techniques for managing the local workforce, an aspect not to underestimate due to culture differences among the various countries that sometimes may result in work inefficiencies or contrasts.

The clusters of choices above outlined, when combined together, result in the formulation of two primary international strategies, and two additional ones which may be considered as an evolution of the formers. The primary strategies are the *multidomestic* and the *global.* The others are the *complex global strategy* and the *transnational strategy*.

Starting from the "multidomestic strategy", the focus here is to locally replicate the entire set of business activities in such a way to have an international – although dispersed – structuring of the resources and at the same time give extensive autonomy to the subsidiaries. This strategy is often called *regionalization,* in fact, the key point for multidomestic industries is to generate competitiveness on a

[49] C. A. Bartlett and S. Ghoshal, *Managing Across Borders: The Transnational Solution*, updated 2nd edition, Cambridge, Harvard Business School Press, 2002.
[50] C. A. Bartlett and S. Ghoshal, *cit. op.*
[51] C. A. Bartlett and S. Ghoshal, *cit. op.*

country-by-country basis rather than a global basis[52]; niche companies generally adapt their products to satisfy the high demands of differentiation and ignore economies of scale because integration is not extremely relevant. To what it concerns the autonomy, managers at top levels have the possibility to run their subsidiaries as quasi-independent organizations; in other words, they are given the authority to make decisions on their own investment locations, product mixes, and competitive positioning. This strategy is particularly favored by newly developed economies and developing or emerging economies due to cultural or national differences; these countries may indeed result more interested in products and services which satisfy their needs, consequently, companies must focus on the necessities of each country or region's local market.

The "global strategy" is the other primary international strategy and it depicts the exact opposite situation of the multidomestic strategy. According to this approach, activities such as research and development, procurement, and production are centralized because they benefit from supranational economies of scale[53], while activities such as sales are locally replicated in order to standardize market approaches and leave to subsidiaries very low levels of discretionary power.[54] The rationale of this strategy is indeed "to compete by establishing worldwide economies of scale, offshore manufacturing, and international cash flows"[55]; by adopting this strategy, hence, the world is treated as an undifferentiated worldwide marketplace through the establishment of worldwide operations and the development of standardized products and marketing. Many studies have tried to identify the reasons why the global strategy is adopted, especially by multinational

[52] H. Deresky, *cit. op.*
[53] In terms of economies of scale, this situation leads to global strategies based on price competition; for this reason, mergers and acquisitions often occur.
[54] A. Dossi, *cit. op.,* pp. 69-70, 1994.
[55] H. Deresky, *cit. op.*

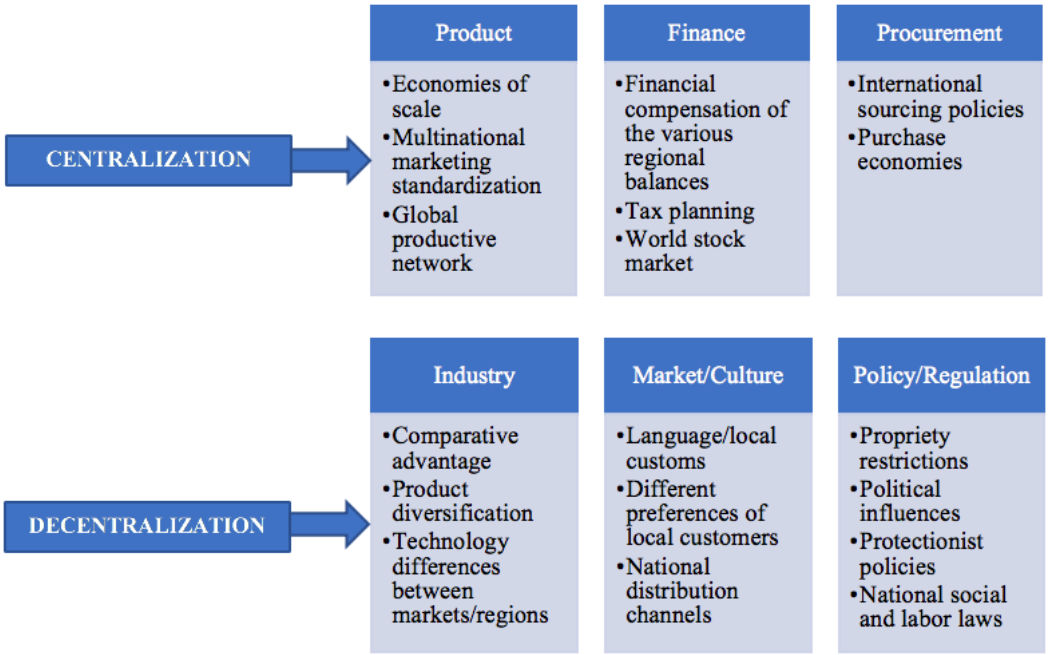
corporations, and one in particular has shown that they are subjected to a sort of pressure to globalize, which includes:[56]

- increase competitive clout resulting from regional trading blocs;
- declining tariffs, which encourage trading across borders and open up new markets;
- the information technology explosion which makes the coordination of far-flung operations easier and also increases the commonality of consumer tastes.

These two primary international strategies, as just described, are completely antithesis strategic positions, and they are attributable to the tradeoff global integration vs. national responsiveness.[57] The pursuit of these two guidelines is indeed justified by opposite factors, as a consequence, the achievement of one's benefits is to the detriment of the economies attainable with the other.[58] This last observation may be better perceived by taking a look at figure 2.2, where the international factors of the centralization vs decentralization dilemma are exposed. In fact, the adoption of one of the two favors different features with respect to the other; product, finance and procurement are the main international factors of the centralization strategy, while industry, market and regulations are the main international factors of the decentralization strategy.

[56] A. Rugman and J. P. Doh, Multinationals and Development*, New Haven: Yale University Press,* 2008, pp. 12–14.
[57] A. Dossi, *cit. op.,* pp. 70, 1994.
[58] A. Dossi, *cit. op.,* pp. 70, 1994.

Figure 2.2 - The international factors of the centralization vs decentralization dilemma



Adapted from A. Dossi, I sistemi di pianificazione e controllo nelle imprese multinazionali, *Sviluppo e organizzazione,* n. 142, 1994, pp. 69.

To what it concerns the other strategies, they are deemed as an evolution of the primary ones due to the fact that the latter have recently been considered as obsolete. The motives behind it are mainly environmental factors and determinant choices taken internally by the majority of the firms, which made them qualifiable as unidimensional and based on a rigorous application of the trade-off decentralization versus centralization. Since then, multinational companies who pursued global strategies where pushed to increasingly scatter their manufacture activities, while those who pursued multidomestic strategies understood that the focus on local adaptation also needed the centralization of some activities (R&D,

finance, but also manufacturing activities).[59] Also, multinational companies once understood the potential exploitation of price differentials and/or the local niches, started to look for marketing activities more local specific. In addition, the ability to adopt a modular production allowed companies to adapt the costs of the products to local tastes, although an adequate standardization level of components and production processes has been maintained.[60] The combination of the aforementioned differentiated choices has allowed to obtain economies of productive integration at global level and economies of commercial adaptability at local level, at the same time.[61] This leads to the first of the two secondary strategies, the "complex global strategy", which consists in the constant search for an adequate balance between national responsiveness and global integration to structure in function of the characteristics of the various businesses, industries, functional activities and the single management policies. As per the "transnational strategy", this approach cannot be identified just as an evolution of the primary strategies because it would be reductive; due to its nature of advanced internationalization, this strategy not only involves the fulfillment of economies of integration and adaptability, they strive for an additional purpose: the globalization of learning. This new concept provides a network where competences created locally and shared globally are spread across the company's organizational structure (together with the network of transfers of products, services, and sometimes managers too).[62] The hypothesis that stands on the basis of this concept is that the very first competitive advantage of a multinational company deriving from internationalization is its ability to exploit the learning potential of its resources around the world. However, the success of the transnational strategy is influenced by managers who are able to facilitate two milestones, the "development of

[59] A. Dossi, *cit. op.,* pp. 71, 1994.
[60] A. Dossi, *cit. op.,* pp. 71, 1994.
[61] A. Dossi, *cit. op.,* pp. 71, 1994.
[62] A. Dossi, *cit. op.,* pp. 72, 1994.

knowledge"[63] and the "sharing of competences"[64]. In substance, the transnational strategy aims at:

- balancing global integration and local adaptability;
- having a production and service system that allows high levels of differentiation;
- being able to work on those resource and competence centers that are geographically located in the most appropriate locations;

Consequently, this strategy allows the multinational corporation to gain cost advantages as well as differentiation advantages. In other words, the transnational strategy allows the company to build its competitive advantage on simultaneously obtaining efficiency, adaptability to the final national customer, and learning exploitation.[65]

The conflict between global integration and national responsiveness, which determines the above cited strategies, may be hence summarized in figure 2.3.

[63] The single subsidiaries or business units of the firm must be an integral part of the environment in which they live in order to get access to the knowledge locally available. This means that the corporate will accept the fact that these subsidiaries will have more autonomy, especially in building network of contacts and agreements to better integrate with the local agents.

[64] The development of managerial practices whose aim is to spread the competences coming from every corner of the structure is necessary. Competences must be transferred horizontally in order to be replicated in each domestic environment, and they must be intertwined at global level so that the company will be able to innovate products, processes, but also managerial and competitive practices. In other words, besides the vertical relationship "corporate-subsidiary" which is however subjected to some changes, the horizontal relationship "subsidiary-subsidiary" emerges, and it becomes critical to manage due to the fact that it introduces new levels of complexity in the decisional processes. This milestone also explains why the transnational is often considered as a global integrative strategy.

[65] C. A. Bartlett and S. Ghoshal, The multinational corporation as an interorganizational network, *Academy of Management Review,* Vol. 15, 1990.

Figure 2.3 - Global integration vs National responsiveness

Global Integration		
High	GLOBAL STRATEGY	TRANSNATIONAL STRATEGY
Low	COMPLEX GLOBAL STRATEGY	MULTIDOMESTIC STRATEGY
	Low	**High**
		National Responsiveness

Adapted from information in C. A. Bartlett and S. Ghoshal, *Managing across borders: the transnational solution*, 2nd edition, Boston, Harvard Business School Press, 1998.

As depicted in the graph, the vertical axis measures the need for global integration, meaning that the movement up the axis results in a greater degree of economic integration. The horizontal axis measures instead the need for multinationals to respond to national responsiveness or differentiation; in other words, it suggests that multinational corporations should address local tastes and government regulations, which may result in a geographic dispersion of activities or a decentralization of coordination and control for individual multinationals.[66] By matching the two axes, the graph shows the four international strategies above described and places them on the basis of the degrees of global integration and national responsiveness:

- the global strategy is placed in quadrant 1;
- the international strategy is placed in quadrant 2;

[66] C. A. Bartlett, S. Ghoshal, *cit. op.*

- the transnational strategy is placed in quadrant 3;
- the multidomestic strategy is placed in quadrant 4.

From their positioning on the graph, it is perceptible that the global and the multidomestic strategy are the primary approaches while the others are an evolution of them; this is possible to grasp because of the balance between the high presence of one characteristic to the detriment of the other (e.g. in global strategy the need for integration is high and the national responsiveness is low, in multidomestic strategy the other way around verifies). On the contrary, the international and the transnational strategy present more complex environmental situations. First of all, the international strategy, which presents a case where both the need for integration and awareness of differentiation are low, is a mixed approach where the potential to obtain economies of scale and the benefits of being sensitive to differentiation are of little value, as a consequence, the international standardization of products and services is favored. This situation leads to lower needs for centralized quality control and centralized strategic decision making, it also eliminates requirements to adapt activities to individual countries. The opposite case is presented by the transnational strategy, where there is a strong need for integration in production and at the same time there is a higher requirement for regional differentiation. This last one is the most challenging strategy due to the difficulty of matching the need for differentiation with the one for integration[67], but, it is also the strategy where successful multinational corporations would seek to operate because of the benefits brought by the two – however, due to the difficulty of creating a global fully integrated environment, those benefits are only achievable by companies who are able to find appropriate synergies in global corporate functions.

[67] One of the main problems presented by this strategy is to face the cultural challenges associated with "localizing" a global focus.

The appropriateness of each strategy depends on the pressures for cost reduction and local responsiveness in each country served.[68] The multidomestic strategy for example, would be successful in countries where there is high pressure for local responsiveness and low pressure for cost reduction, consequently, where there is likelihood that differentiated products and services will be responsive to local needs. The global strategy, on the contrary, would fit those countries where the pressure for cost reduction is high, and there is low demand for localized product offerings; by offering a standardized product worldwide, firms can leverage their experience and use aggressive pricing schemes. As per the complex global strategy, countries where there is no pressure for local responsiveness and cost reduction would represent the ideal situation; in addition, firms who pursue a complex global strategy have valuable core competencies that host-country competitors do not possess, and for this reason they success in those countries. As per the transnational strategy, finally, this one is successful when there are high cost pressures and high demands for local responsiveness; however, as above explained, it is a very challenging strategy to pursue effectively, because of the contradictory demand that characterizes it – in fact, localized products increase costs.

In any case, according to the Indian-American economist P. Ghemawat "strategy cannot be decided either on a country-by-country basis or on a one-size-fits-all-countries basis, but rather that both the differences and the similarities between countries must be taken into account". In saying that, he elaborated a distance framework which identifies the cultural, administrative, geographic and economic differences (or distances) between countries that companies should address when crafting international strategies, named CAGE.[69] In essence, the strategic choice as to where a company should position itself is dependent on the

[68] C. A. Bartlett and S. Ghoshal, *cit. op.*
[69] P. Ghemawat and J. Siegel, Cases about Redefining Global Strategy, *Harvard Business Review Press*, Chapter 2, 2011.

nature of the industry, the type of the company, the company's goals and strengths (or weaknesses), and the nature of its subsidiaries, among many factors. This set of decisions is enclosed in the CAGE framework, where:

- *cultural distance,* measures the differences in values, languages, religion, trust, and other national implications;
- *administrative distance,* examines the lack of common trading block or currency, political hostility, non-market or closed economy;
- *geographic distance,* measures the remoteness of the country, the different time zones, the weakness of transportation or communication links;
- *economic distance,* measures the differences in the level of development, natural or human resources, infrastructure, information or knowledge.[70]

On the basis of these considerations, hence, each company's strategic approach should be unique and perfectly studied in order to adapt at the best to the new environment.

Another aspect to consider while examining the various international strategies, concerns the role of the corporate and how this changes according to the configuration "national responsiveness vs. global integration" for which the company has opted. In table 2.1, the set of international strategies is showed together with the main features and role that the corporate assumes. Starting from the multidomestic strategy, the role of the corporate is comparable to the one of a "finance manager", or rather a role as the interface among capital markets[71] and subsidiaries. The reason behind it is the presence of organizational configurations where the geographical dimension represents the maximum priority and, as a consequence, critical decisions are oriented towards strategic and operational country rationality.[72] Moving to the global strategy, here the role of the corporate

[70] H. Deresky, *cit. op.*
[71] To what it concerns dividend policies and the acquisition of own/third party equity.
[72] A. Dossi, *cit. op.,* pp. 70, 1994.

takes the form of a "commander", or rather the only decision-maker of all the functioning aspects of the company's system. This means that the corporate detains the resources and the power to standardize both the characteristics of the product and the approach to the market because the rationality behind the decisions is focused on the achievement of economies resulting from the exploitation of resources such as R&D, procurement, manufacturing, and so on.[73] As per the complex global strategy, with this approach, strategic decisions are still centralized; however, subsidiaries and business units are considered as partners for the production of products and services – led by the corporate – but above all for the commercialization phase – where the attention is focused on the greater local adaptability to get premium prices from local markets. For this reason, the network of manufacturing in which the various business units are included together with the centralization of business' logics, make the corporate a "central integrator" of the system. In other words, the corporate is the one who has the power to establish policies such as the allocation of resources, the planning cycle, the budgeting and monitoring process, coordination mechanisms[74], but the subsidiaries gain a new role, which is not anymore a role of agents (global strategy) or responsible for the country served (multidomestic strategy), it is a position of partnership with the corporation. Lastly, the transnational strategy presents an additional role of the corporate, that is the one of "key connector" of the system. Due to the complexity of the strategy, a likewise level of difficulty in defining the role of the corporate is found. On the one hand, it acknowledges the status of sources of ideas, scientific competences and knowledge to business units; on the other hand, the managerial solutions adopted must be flexible in order to dynamically search for adaptability in some markets and integration in others.[75] This situation generates dispersion of resources and network of knowledge transfer among the firm's business units, for

[73] A. Dossi, *cit. op.,* pp. 70, 1994.
[74] Usually, transfer prices for intragroup operations.
[75] A. Dossi, *cit. op.,* pp. 73, 1994.

this reason, the role of key connector of the system is fundamental. This position – although with a high effort of management of organizational processes – provides the corporate with the power to manage acquisition and allocation policies, as well as the interweaving of widespread knowledge in the organization.

Table 2.1 - International strategies and role of the corporate

Strategic choice / Key elements	MULTIDOMESTIC	GLOBAL	COMPLEX GLOBAL	TRANSNATIONAL
Environmental characteristics	Protectionism High costs Marketing differs by country	Standardization International marketing Cost reduction	New protectionism International marketing segmentation	National marketing sophistication Dispersion of resources
Management philosophy	Adaptability	Integration	Adaptability Integration	Learning
Competitive focus	Revenue	Costs	Cash flow	Competences
Critical organizational dimension	Country	Function	Business	Not definable
Decisional process	Decentralized	Centralization	Integrated	Customized for the decision in question
Shared resources	Finance R&D	Finance R&D Procurement Manufacturing	Finance R&D Manufacturing	Finance Distinctive competences
Role of subsidiaries	Responsible for country business	Agents	Partners	Sources of knowledge
Role of the corporate	FINANCE MANAGER	COMMANDER	CENTRAL INTEGRATOR	KEY CONNECTOR

Adapted from A. Dossi, *cit. op.*, pp. 70, 1994.

The role of the corporate in multinational companies is, hence, subjected to a double pressure: on the one hand, it must be in line with the strategic choices undertaken, on the other hand, it must put into practice a very wide set of mechanisms, with the necessity to coherently compose them in a system of connections. Among these systems, the "planning and control system" takes on a critical value.[76]

2.2 Management control systems

Multinational corporations, as explained in the sections above, are those companies who operate in more than one nation; as such, they have international subsidiaries to manage, which need to adapt to economic, political and other conditions in the respective host countries[77], but also need to overcome geographical and cultural divides to manage their operations.[78] According to this perspective, the adoption of a management control system across borders becomes crucial for multinational companies, in particular, because it helps aligning foreign subsidiaries – as well as employees and their decisions/actions – with corporate goals.

A management control system is "a means of gathering and using information to aid and coordinate the planning and control decisions throughout an organization and to guide the behavior of its managers and other employees".[79] It is characterized by three main elements[80]:

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[76] A. Dossi, *cit. op.,* pp. 74, 1994.
[77] C. Endenich, M. Brandau and A. Hoffjan, Two decades of research on comparative management accounting – Achievements and future directions, *Australian Accounting Review,* vol. 21, pp. 365, 2011.
[78] J. F. Dent, Global competition: challenges for management accounting and control, *Management Accounting Research,* vol. 7, 1996.
[79] C.T. Horngren, S.M. Datar, M.V. Rajan, *Cost accounting. A managerial emphasis* (15th edition), Pearson Education, Inc., New Jersey, 2015, pp. 841.
[80] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

- responsibility centers, or rather the different typologies of organizational units to which accountabilities for economic-financial results achieved by the firm are assigned;
- the process in which the control system is organized, or rather the phases through which control is developed, such as the identification of the annual objectives, the preparation, negotiation, revision of the budget, the monitoring of intermediate and final results, and so on;
- the technical-financial structure of support, or rather the accounting tools, reporting and analysis models that constitute management accounting, such as budgeting, performance indicators, cost accounting, variance analysis, final results schemes, and so on.

Management control systems can be identified as formal or informal systems. As per the formal systems, they include specific rules, procedures, performance measures, and incentive plans with the aim of guiding the behavior of managers and employees. Formal control systems are composed of other set of systems[81], such as:

- the management accounting system, which provides information regarding costs, revenues and income;
- the human resources system, which provides information regarding the recruiting and training of employees, absenteeism and accidents;
- the quality system, which provides information regarding defective products, late deliveries to customers, and so on.

As per the informal control systems, these are controls that do not require rules or procedures to follow because they include the shared values, loyalties, mutual commitments among the members of the organization, the company's culture, and the unwritten norms about acceptable behavior for managers and employees.

[81] C.T. Horngren, S.M. Datar, M.V. Rajan, *cit. op.,* pp. 842.

The design of an efficient reporting system is fundamental to ensure that actual performance is coherent to expected organizational standards and objectives. The main feature of a management control system is indeed "to coordinate far-flung operations in vastly different environments with various work processes, rules, and economic, political, legal and cultural norms".[82] In addition, the response of the control process timely signals any necessary change in strategy, structure, and operations.

Control in multinational companies is usually differentiated under three forms[83]: process (or substantial) control, output (or administrative) control and social (or cultural) control. The extent of control influences the ability of multinational companies to pursue global strategies. Multinational corporations, in fact, combine several mechanisms to control the activities of their units: generally, the integration of output and process control mechanisms with social controls allows the company to meet coordination requirements. The understanding of what the mechanisms in question are and how to use them to generate strategic alignment and learning are two "strategic questions"[84] that the corporation needs to wonder.

First of all, to answer the question *what the mechanisms of control are*, it is possible to refer to the Prahalad and Doz model[85] depicted in figure 2.4. According to the model, a multinational company is based on two forms of control:

- the substantial control, well-known as process control, is the one that concerns the allocation of the company's most critical resources, whether they are financial, managerial or technological resources. It is based on a form of coercion which provides that the resources are distributed only if

[82] H. Deresky, *cit. op.*
[83] C. K. Prahalad and Y. Doz, *The Multinational Mission: balancing local demands and global vision*, The Free Press, 1987. C.A. Bartlett and S. Goshal, Managing Across Borders, *Harvard Business School Press,* Boston, 1989.
[84] A. Dossi, *cit. op.,* pp. 25, 2016.
[85] C. K. Prahalad and Y. L. Doz, *The multinational mission: balancing local demands and global vision*, The Free Press, London, 1987.

there is objectives' sharing and consequently an alignment of behaviors along the organizational structure is present. The efficacy of this control system is shown on the graph; by taking a look at figure 2.4, it is possible to see that the curve S – S' is a function of the high level of centralization of resources to the headquarter and of the high dependency of regional (or national) business units from central resources. The system reveals that this control form has a limited efficacy, especially in the recent environment, where local business units:

  - aim at acquiring always more autonomy from a financial point of view (business units must generate enough cash flow to cover at least local investments);
  - pay attention to the sites where to assimilate new talents (the aim is to develop a management that is ready for undertaking global positions);
  - pay attention to find innovation sources (business units must start to generate innovative ideas, particularly market-oriented).

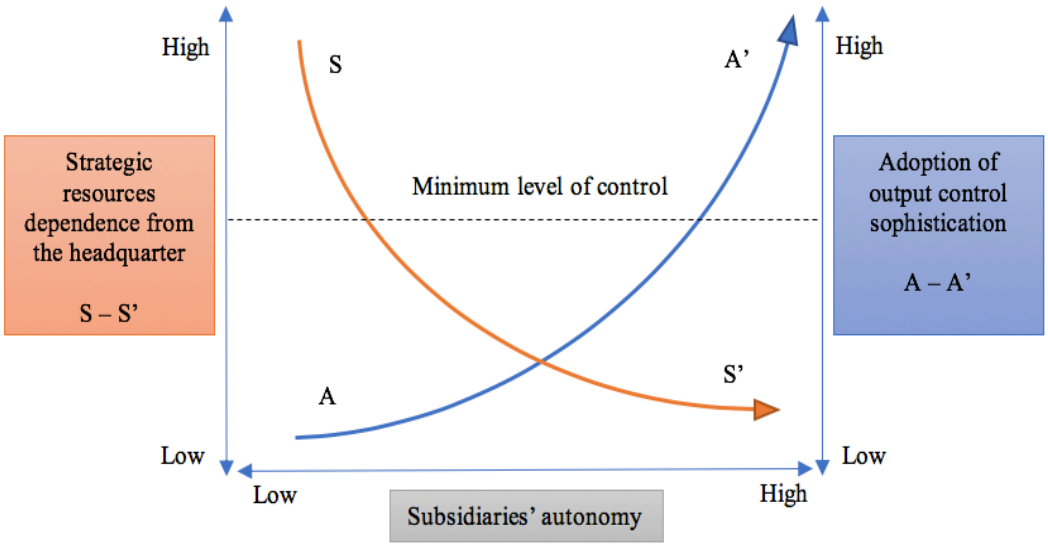
  In other words, the increasing autonomy of local business units makes the dependency from the headquarter always less efficient, leading to a loss of influence and coordination for the substantial control.

- the administrative control, also known as output control, aims at balancing the control exerted by the substantial control, and in figure 2.4 is represented by the curve A – A'. It consists in the adoption of a set of mechanisms with the purpose of connecting plans, programs, policies and decisions for the analysis and balancing of global competitive advantages with local peculiarities.[86] This control process is based on three different mechanisms, or levers, which can be seen in figure 2.5. Starting with mechanisms of data management, they include all those systems such as the planning system,

[86] A. Dossi, *cit. op.,* pp. 27, 2016.

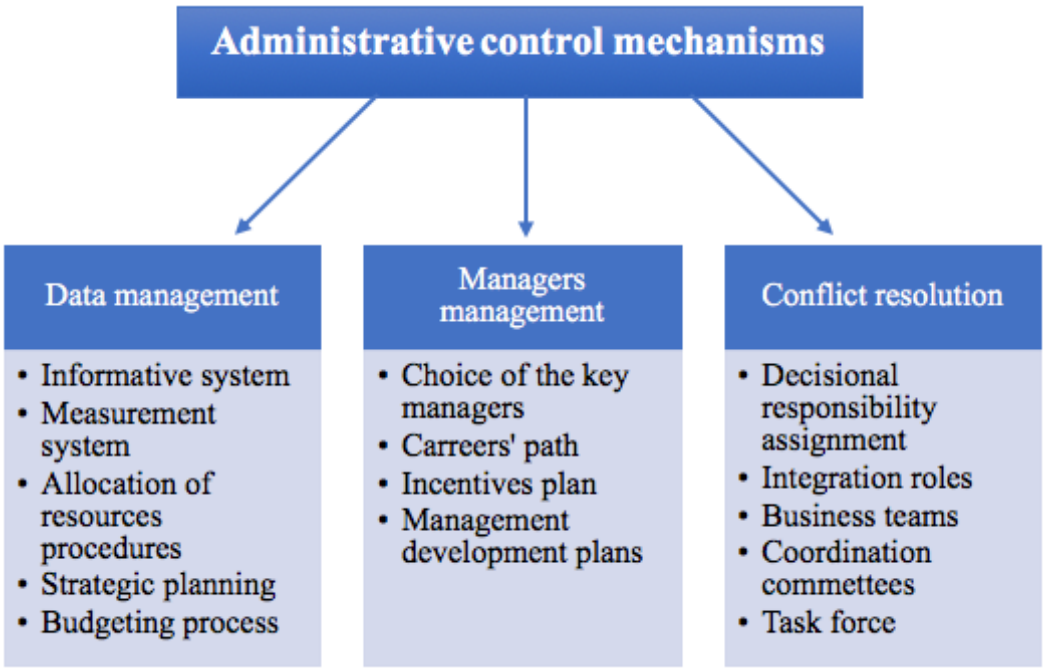
the investment analysis, the budgeting and the reporting. As per the mechanisms of managers' management, they include both the selection and the training phases of key job positions, but also the incentives system and accountability system. The mechanisms of conflict resolution, finally, include those systems who capture and send signals to the organization for those perspectives that are considered to be of critical importance for the elaboration of firm's policies. These levers are what the top management has to invest on in order to develop its international management and control system.

Figure 2.4 - Management and control systems mechanisms in multinational companies



Adapted from A. Dossi, Internazionalizzazione sotto controllo, *Economia e Management*, fasc. 5-6, 2016, pp. 26.

Figure 2.5 - Administrative control levers



Adapted from A. Dossi, *cit. op.*, 2016, pp. 26.

Secondly, the answer to the question *how control mechanisms might be used to generate strategic alignment*, may be found in Simons' model of strategic control levers[87]. According to the model, observable in figure 2.6, there are four different guidelines that must coexist in a company to make sure that strategic alignment is achieved[88], and these are:

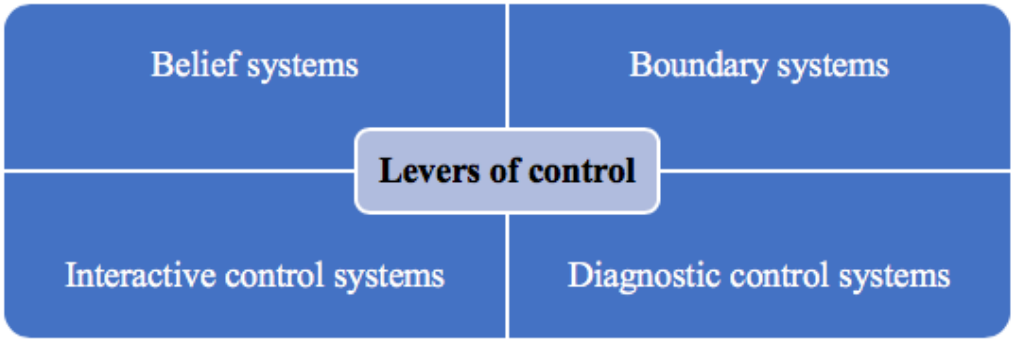
- Perspective. Strategy must be seen as a firm's development perspective, or rather a unique vision of the evolution of the environment and of the firm's role itself. The aim is to motivate those who work in the organization to look for and create opportunities to achieve the global mission. In this sense,

[87] R. Simons, *Levers of control. How managers use innovative control systems to drive strategic renewal,* Harvard Business Review Press, 1994.
[88] A. Dossi, *cit. op.,* pp. 27, 2016.

control mechanisms should be used as *belief systems*, whose aim is to translate the evolution perspective in directions and guidelines;

- Positioning. Control mechanisms should be used as *boundary systems,* whose aim is to clearly communicate the accepted limits of local entrepreneurship. The reason of the communication is to understand what is the competitive path that the firm wants to pursue with respect to its competitors;
- Plan. Strategy must be seen as a set of objectives and actions. In this sense, control mechanisms should be utilized as a *system of diagnostic control* which allows managers to measure the results, compare them with the objectives, understand the degree of achievement of the strategies, and deliberate about whether the failure in implementation is due to lack of resources or unforeseen events;
- Behavior and action methods. Multinational corporations operate in strategic uncertainty conditions due to the fact that, even though a strategy has been formalized and communicated, its implementation at local level implies testing and research. For this reason, the strategy emerges as a coherent set of behavior and action methods. Consequently, control mechanisms should be used as a *system of interactive control* underpinned by a dialogue between units; this latter, in particular, is necessary to stimulate emergent strategies and make them transferrable between one unit and another.

Figure 2.6 - R. Simons' model



Adapted from R. Simons, *cit op.,* 1994.

Hence, the strategic alignment in a multinational company grows up from the use of management and control mechanisms in such a way that belief systems, boundary systems, systems of diagnostic control and systems of interactive control oversee the implementation of the global planned strategies and stimulate coordinated emergent local strategies.[89]

In addition, a high emphasis on various control mechanisms is associated with superior performance, particularly, when pooling substantial controls with administrative controls. Complementing output controls with process controls, indeed, helps reducing negative effects of geographical or cultural distance. The tightness of control depends on the degree of internationalization as well as on the necessity of local adaptation.[90] In general, management control is tighter when the importance of a subsidiary in terms of size or investment is high, subsidiary

[89] A. Dossi, *cit. op.,* pp. 27-28, 2016.
[90] L-H. Lin, Subsidiary performance: the contingency of multinational corporation's international strategy, *European Management Journal,* vol. 32, pp. 928–937, 2014. And J. I. Martinez, J. C. Jarillo, Coordination demands of international strategies, *Journal of International Business Studies*, vol. 22, pp. 429–444, 1991.

performance is perceived as unsatisfying or it is threatened by the competition in the market.

2.2.1 Output control

Output control, or administrative control, is a management control form based on the traditional mechanisms of planning, budgeting, reporting and performance measurement. They represent the main channel through which subsidiaries and business units might act, coherently with the strategies elaborated at corporate level.[91] Multinational corporations indeed, spread performance measurement systems worldwide to share strategies and goals[92] and influence the decisions of their subsidiaries. In order to do this, it is necessary for the company to have financial figures to refer to, due to their high acceptance and comparability across countries.[93]

The most spread financial figure is represented by *reporting*; reporting serves as a pillar of management control at foreign subsidiaries due to the support that it provides to performance measurement system and goals achievement[94], and it also allows the headquarter to gain insights into local business figures.[95] In order to be effective, reporting must be reliable and timely; consequently, it needs to adopt detailed process descriptions – this is the reason why multinational corporations

[91] A. Dossi, *cit. op.,* pp. 75, 1994.
[92] Performance measurement systems represent a strategy to comply with countries' specific requirements.
[93] A. Dossi and L. Patelli, You learn from what you measure: financial and non-financial performance measures in multinational companies, *Long Range Planning*, vol. 43, pp. 498–526, 2010.
[94] L. H. Chung, P. T. Gibbons and H. P. Schoch, The management of information and managers in subsidiaries of multinational corporations, *British Journal of Management,* vol. 17, pp. 153-165, 2006.
[95] P. Finnegan and S. Ni Longaigh, Examining the effects of information technology on control and coordination relationships: an exploratory study in subsidiaries of pan-national corporations, *Journal of Information Technology,* vol. 17, pp. 149-163, 2002.

usually rely on their subsidiaries' expatriates to ensure direct reporting lines.[96] In addition, an efficient reporting implies the need for a coordinated approach of different mechanisms, hence, multinational companies use integrated systems to achieve consistency in reporting.

Budgeting and budgeting controls represent another relevant means for controlling foreign subsidiaries and they often represent the basis for performance measurement systems and incentives. Unlike the reporting, the budgeting process is usually built up on the basis of communication and information flows between the headquarter and its subsidiaries due to the fact that the budgeting process itself seems to be strongly affected by the background of the respective country – particularly, with regards to the importance of budgeting and the level of detail of the budget.[97] Indeed, when a subsidiary gets involved in the budgeting process, its commitment to the budget seems to be enhanced. As a consequence, an additional aspect to consider in the examination of output control is the evolution of its usage in multinational companies. On the one hand, the time span that goes from the 1990s to the early 2000s highlights that the effects of budgeting on financial performance were a key issue; on the other hand, later studies enhanced the impact of headquarters nationality, culture distance and external environment on the budgeting process as an additional aspect of relevance to consider while implementing management control in foreign subsidiaries.

As previously mentioned in the paragraph, the administrative control includes a set of useful mechanisms which may be divided among human resources management processes – such as the choice of key-managers, the definition of career paths, incentives system and so on – and conflict resolution management – such as the creation of internal departments, issue resolution processes, and so on.

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[96] M. Sageder and B. Feldbauer-Durstmuller, Management control in multinational companies: a systematic literature review, *Review of Managerial Science,* Austria, 2018.
[97] A. Hoffjan, R. Trapp, C. Endenich and T. Boucoiran, International budgeting – challenges for German French companies, *Journal of Management Control,* vol. 23, pp. 5-25, 2012.

By including these mechanisms in the output control, the company is able to realize the essential role that they have in the reinforcement of the planning process, as well as the process of objectives-assignment and the evaluation of results. In other words, the proactive and coherent management of these systems allows the multinational corporation to have a full governance of both vertical and horizontal relations between headquarter and foreign subsidiaries.[98]

2.2.2 Process control

Process control, or substantial control, implies the centralization of the acquisition, management and development of strategic resources imposed by the headquarter.[99] In order to develop a centralized management style, capable of monitoring operational business to inform decision makers at headquarters, a management information system is necessary. By introducing a management information system indeed, permanent information flow would be guaranteed – which results essential for a centralized coordination of multinational corporations. These systems allow real-time monitoring and coordination worldwide, which either reinforce centralization tendencies or strengthen local responsiveness.[100] With this regard, it is important to consider that paying attention to local specificities, like language or legal requirements, represents a key factor to launching such systems in foreign subsidiaries successfully.[101]

There are many reasons why the corporate decides to centralize some resources, considered strategic, such as[102]:

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[98] A. Dossi, *cit. op.,* pp. 75, 1994.
[99] A. Dossi, *cit. op.,* pp. 74, 1994.
[100] P. Finnegan and S. Ni Longaigh, *cit. op.,* 2002.
[101] D. Avison and J. Malaurent, Impact of cultural differences: a case study of ERP introduction in China, *International Journal of Information Management,* vol. 27, pp. 368-374, 2007.
[102] A. Dossi, *cit. op.,* pp. 74, 1994.

- the necessity to directly manage the key resources in order to pursue a long-term strategy. Research and development for instance, is an activity which is typically centralized, especially in pharmaceutical companies, due to the importance of the activity itself and above all, to avoid classified information disclosure;
- the possibility to achieve economies of scale and/or experience economies in certain functions, such as the procurement and manufacturing activities;
- the possibility to achieve economies of collection and minimization of the cost of capital, as well as the compensation of national currency and fiscal positions, brought about by the centralization of the financial resource governance.

From this first analysis, it is evident that process control is effective in the governance of the vertical relationships between corporate and subsidiary[103], while it presents some application limits for horizontal relationships among subsidiaries. The introduction of such systems shows two main effects: on the one hand, it facilitates control of worldwide activities and reduces information asymmetries between headquarters and subsidiaries through monitoring and standardization; on the other hand, it limits decision rights of subsidiary managements and strengthens centralization tendencies.[104]

2.2.3 Social control

Social control, or cultural control, implies a form of guideline for behaviors based on cultural variables, or rather on the sharing of beliefs, values and role models.[105] This typology of control is also called "clan control", a term that

[103] The reason behind it is that the centralization of strategic resources is more applicable in a hierarchy (corporate-subsidiary) rather than among two subsidiaries at the same hierarchical level.
[104] P. Finnegan and S. Ni Longaigh, *cit. op.,* 2002.
[105] A. Dossi, *cit. op.,* pp. 75, 1994.

indicates "the informal socialization mechanisms that take place and that facilitate shared values, beliefs, and understandings among organizational members".[106] Such control is indeed implemented by promoting a set of common values and beliefs and by exerting social control on a group of individuals, otherwise known as a "clan", to identify with the group and its values[107]. Clan control exists when groups exhibit behavior that is motivated by shared values and norms, individuals attempt to be "regular" members of the group by behaving in a manner consistent with accepted behaviors, and the group accordingly rewards or censures its members[108].

In social control, there are three main aspects to consider for controlling foreign subsidiaries: communication and collaboration, the role of expatriates and training.

First of all, social control mechanisms like training, informal communication and meetings are those tools that mainly help to initiate a performance-based culture at a subsidiary, convey corporate values and pave the way for process and output controls.[109] After that, networks are always more often taking place in multinational environments due to the role of communication enhancement within an organization; in addition, these tools may be reinforced by expatriates once arrived at the foreign subsidiaries. The aim of these mechanisms is to establish a regular communication (including the possibility of exchanging information among business units to have positive effects on performances) that is able to ensure employees commitment to reporting procedures and to facilitate knowledge transfer between units – in this way, the implementation and the reinforcement of the

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[106] K. L. Turner and M. V. Makhija, The role of organizational controls in managing knowledge, *Academy of Management Review,* vol. 31, pp. 197-217, 2006.
[107] A. J. Berry, J. Broadbent and D. T. Otley, *Management control: theories, issues and performance*, 2nd edition, Palgrave Macmillan, Basingstoke, England, 2005.
[108] W. G. Ouchi, A conceptual framework for the design of organizational control mechanisms, *Management Science,* vol. 25, pp. 833-848, 1979.
[109] F. B. Al-Husan and P. James, Cultural control and multinationals: the case of privatized Jordanian companies, *International Journal of Human Resources Management,* vol. 14, pp. 1284-1295, 2003.

efficiency of performance measurement systems would also be favored by communication.

Secondly, multinational companies have recently introduced expatriate manager to reform corporate culture in order to transfer knowledge to subsidiaries and to ensure reporting and performance monitoring, as well as compliance with corporate practices and procedures.[110] Expatriate managers generally hold positions on the management board with extensive control and coordination responsibilities, in this way, they perform output and process control besides social control. However, the company should not employ too many expatriates, otherwise it would be translated in a tight subsidiary control from the headquarter.[111] Another aspect to consider is that only expatriates with appropriate knowledge of the host country's culture can contribute positively to management control at foreign subsidiaries.

Last but not least, trainings are usually organized to convey skills and knowledge and to ensure that control mechanisms are applied appropriately in a multinational setting, is usually associated with the introduction of a management information system.[112] When entering a foreign country, for instance, trainings assist managers in building networks and spreading corporate values and strategies throughout the multinational company.[113] To some extent, it is possible to say that training substitutes expatriates for cost-efficiency reasons.[114]

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[110] Y. Y. Chang, K. Mellahi and A. Wilkinson, Control of subsidiaries of MNCs from emerging economies in developed countries: the case of Taiwanese MNCs in the UK, *International Journal of Human Resources Management,* vol. 20, pp- 75-95, 2009.

[111] L. H. Chung, P. T. Gibbons and H. P. Schoch, The management of information and managers in subsidiaries of multinational corporations, *British Journal of Management,* vol. 17, pp. 153-165, 2000.

[112] Z. Hoque and M. Chia, Competitive forces and the levers of control framework in a manufacturing setting: a tale of a multinational subsidiary, *Qualitative Research in Accounting and Management,* vol. 9, pp. 123-145, 2012.

[113] F. B. Al-Husan and P. James, *cit. op.*

[114] J. Schaaper, S. Mizoguchi, H. Nakamura and S. Yamashita, Control of French and Japanese subsidiaries in China: implementing control mechanisms before and after the global economic crisis, *Asia Pacific Business Review*, vol. 17, pp. 411–430, 2011.

To conclude, social control is considered to be quite expensive in terms of personnel selection and training processes, and in terms of beliefs and values transfer too. In addition, it is classified as an informal control system due to the lack of special mechanisms. For these reasons, it is usually adopted to support horizontal coordination among subsidiaries, and it is used in a less targeted way than process or output control for monitoring foreign subsidiaries.

2.3 The phases of the management control process

The management control process is articulated in four fundamental phases, influenced and related to each other[115]: the programming, the preparation of the budget, the measuring and reporting, and the evaluation of achieved results.

The *programming* phase concerns the identification of the action plans to develop and implement in the course of the forthcoming years, as well as the necessary resources for their realization.[116] This process will allow the company to turn the strategies, defined in the initial planning phase, into real actions and consequently achieve the objectives assigned to each business unit. Programs may be focused in a specific functional area, in more than one, or they may regard the corporation in general; the most important aspect is that they must be in line with the outcomes established in the strategic planning. Once the programming has been initiated, the top management must share the action plans with each division/business unit manager and throughout the organizational structure, in order to obtain an effective implementation. The programming process starts with the analysis and evaluation of the ongoing programs, where some variations with

[115] The role that each phase covers is fundamental for the successful implementation of the control process. For instance, the objectives of the budget must be coherently defined with the action plans and available internal resources identified in the programming phase; the evaluation of the performances may be exerted through the implementation of a shared feedback system that compares the actual results with the planned ones.
[116] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

respect to what has been planned – as well as their causes – should emerge. On the basis of this evaluation the management decides whether it is more appropriate to continue with those programs or if it is necessary to change/stop them. Once the relevant programs for the action plans' implementation have been identified, the management analyzes their convenience and opportunity: they have to evaluate the financial impact of the programs at corporate level, and they have to evaluate the coherence of the programs with actual resources of the company, such as human resources, materials and technology. The programming phase represents a significant process also due to the fact that it is able to verify if the assumptions and strategies elaborated in the strategic planning phase are actually feasible or not. During the translation of the objectives in real actions, indeed, the management may encounter problems and adaptation difficulties which generally result from incongruences between strategic objectives and actual capacity of the organizational structure.

The *preparation of the budget* is the last step in the planning process, and it concerns the short-term financial planning, assuming – coherently – a crucial role in the control process.[117] First of all, the decisions taken in the strategic planning and the programming phase are implemented and improved. Secondly, the business purposes are communicated and shared through the organizational structure, and they are consequently translated in objectives for each responsibility center manager. Thirdly, the analysis and the approval of the sectorial budgets allow the corporate to verify the objectives' opportunities and to make a preventive control on the actions of the managers, before their implementation, in such a way that the corporate is able to ensure the coherence of the budget's objectives with the ones established in the strategic planning and programming phase. In addition, an effective preparation of the budget represents the basis for a valid and reliable evaluation of the overall company's results and also the ones of single responsibility

[117] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

centers. What is more, the objectives structured on infra-annual periods of time allow the implementation of intermediate tests and – whenever a situation where the results are not coherent with the ones predicted in the planning process verifies – to draw up timely corrective actions.[118] Hence, the budget must be in line with the mission and strategies defined in the planning process, as well as with the action plans identified in the programming phase, also, it must be the result of the partial budgets consolidation with reference to the objectives of the single responsibility centers where the organizational structure is articulated.

The budget must be operational from January, 1st of every year; however, the process that constitutes the final budget takes a long time, managers, indeed, start the preparation of the budget at least four months before the closing of the period:

- within the first decade of September, the top management must communicate to lower level managers the guidelines for the budget definition of their corresponding business unit area;
- by the end of September, the sales manager must present an initial prevision of the next administrative period's sales; afterwards, the various business unit managers together with the top management will check the compatibility between the planned volumes and the internal resources (present and future), as well as the coherence with the purposes that it is going to achieve in the period; on the basis of these considerations, the management will decide if the projected sales volume need to be changed or not;
- by the end of October, responsibility center managers have to submit the first version of their sectorial budgets to the top management; after that, a new negotiation phase – aimed at achieving the final budgets – will start;
- by the end of November, all the sectorial budgets together with the final strategic budget must be submitted and approved by the corporate;

[118] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

- by the first half of December, the top management has to communicate to each business unit/responsibility center director the objectives for which they will be accountable for the next administrative period.

The *measuring and reporting* phase concern the set of activities through which the results achieved by the corporation are collected, measured, and communicated; these are then classified according to the program and responsibility center of reference. The measuring phase may be conducted on final or intermediate results: final results are often used for the evaluation of single responsibility center directors, especially because of the need to assign prizes or punishments, while intermediate results are often used to timely highlight strange situations and consequently start corrective actions.[119] In any case, companies generally utilize both of them. In order to make sure that the evaluation of results will be effective, the measuring phase should be performed only on those aspects that are actually considered relevant for the success of the company. The measurement must follow the methods and the unit of measure established during the budget objectives definition, otherwise it would not be possible to compare the results. Once the results have been collected, they are examined and commented in specific control reports, which will be then delivered to the top management or the single business unit managers. In order to have a better view of the reporting system and to understand the way in which it could be best used by corporations, it is important firstly to define it, and then to catch, to find the methodology that better fits the company involved. From a substantial point of view, the reporting system consists in the collection and measurement of a company's results whose success depends on the set of tools implemented and the methodologies adopted[120]; from a formal point of view, the reporting system refers to the representation and periodic

[119] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*
[120] G. Catturi and A. Riccaboni, Economia aziendale e teoria istituzionale: affinità concettuali ed implicazioni operative per il controllo di gestione, in Contabilità e Cultura Aziendale, *Rivista Italiana di Ragioneria e di Economia Aziendale*, vol. 1, 2, 2001.

communication of such measures in the relative management report[121]. In addition, the reporting system may be interpreted:

- in the strict sense, as a narrow group of information produced and destined to management control internal communication;
- broadly speaking, as a set of paper and digital information, produced periodically and with variable content, destined to internal but also external communication.

In order to be effective, the reporting system has to be flexible due to its susceptibility to structural and organizational changes. The reporting system may also be differentiated between[122]:

- institutional reporting, or rather the set of periodical reports destined to shareholders, investors, suppliers, customers, governments, and so on. It allows upper level management to take rational strategic decisions, as well as to evaluate business unit directors' performances (synthetic accounting statements are valid examples of institutional reporting);
- managerial reporting, or rather all those reports necessary at managerial level to be informed about and share throughout the organization the daily business dynamics – it is consequently considered as internal reporting;
- operational reporting, or rather reports such as sales statistics, production timing, and all those statements that satisfy specific cognitive needs from the management in the form of informative system reports.

Hence, the reporting system is basically a coordinated set of elementary documents addressed to managers that are responsible for a particular responsibility center, department or business unit. Formally, reports have to present the following contents:

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[121] G. Brunetti, *Il controllo di gestione in condizioni ambientali perturbate*, Franco Angeli, Milano, 1989.
[122] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

- references to specific managerial responsibilities;
- comparison of final results versus expected (or standard) results;
- evaluation of the results;
- all the significant information relative to what the report is needed for.

The reporting system may be considered effective if it analyzes the final results, however, it is also necessary to register and investigate the variances with the expected results or the standard results. The variance is represented by the difference between two entities or quantities, the *expected or standard value* - i.e. the budgeted quantity to be achieved, established on the basis of historical data or standards - and the *final or actual value* - i.e. the result actually achieved. Therefore, the variance is given by:

Figure 2.7 - The variance analysis

The variance analysis may take different forms, according to the entity that they have to measure, indeed variances may have a global or an elemental nature - where by elemental is meant the decomposition of the global variances. For instance, one of the most important variance analysis is given by the difference between expected and actual revenue (global variance); which can be further split between earnings, fixed costs and variable costs variances (elemental variance); earnings can be even further split between volume, mix, and sales price variances, and so on.

Finally, to what it concerns the timing or the period for the measuring and reporting phase, there is not an established one; it depends on the object of the analysis as well as on the external environment characteristics that are considered to be significant for the observed phenomenon. In any case, it is important to have a timely system of measuring and reporting because of its ability to remove any unpredictable obstacle and to influence managers' activity[123]. Moreover, a systematic measurement of the results brings the involved managers to a personal and cultural growth inside the company because, thanks to the understanding of previous mistakes and the acceptance of proposals to improve their performance, they can implement a continuous process of improvement.

The *evaluation of the achieved results* concerns the last phase of the control process. It starts with the analysis of the results shown in the reports by the direct supervisor of each area, who is able to make a specific evaluation and give an explanation for the determination of certain results.[124] The evaluation consists in the comparison between planned and actual data, and it represents the feedback mechanism which allows the management to analyze the reasons why some relevant variances emerge, to evaluate the efficiency and the effectiveness of the activities, as well as the merits and mistakes of the various initiatives.[125] The evaluation consists also in the analysis of the degree of realization of the programs established in the programming phase, the evaluation of the results achieved by the responsibility centers, and the evaluation of managers' performance. The determined variances – both positive and negative – need to be then investigated, in order to give them an explanation; in fact, negative variances may result either from a manager's mistake or by objectives that were not actually feasible for the

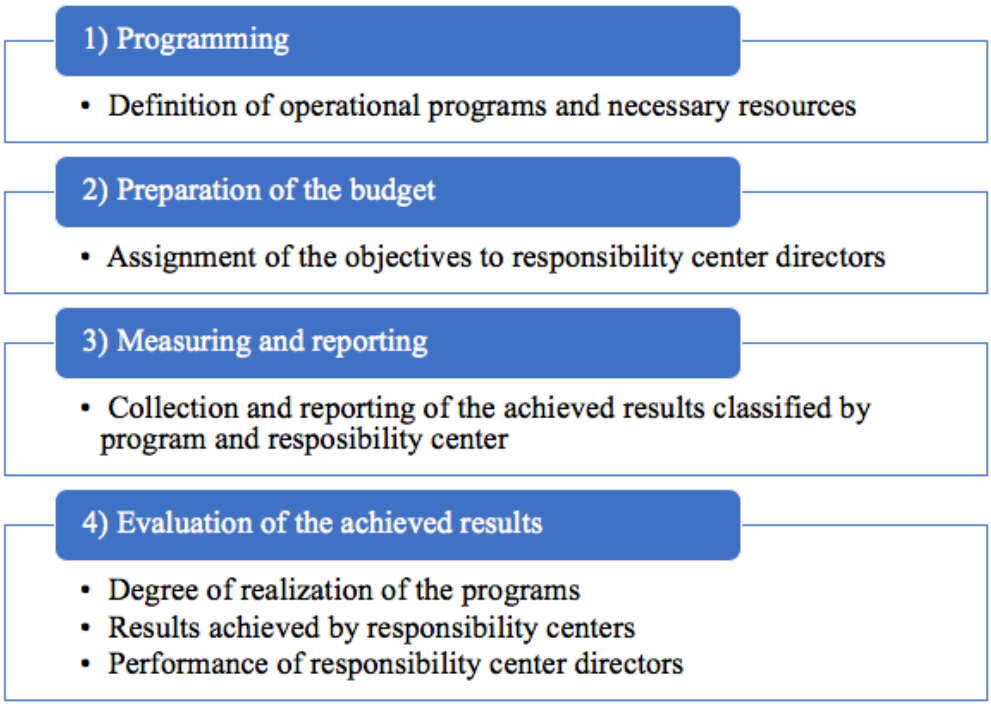
[123] Managers are indeed influenced by the presence of such a system because they are aware of being evaluated by the top management and they are consequently pushed to do their best to achieve the results established (and get bonuses).
[124] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*
[125] A. Riccaboni, *Performance ed incentivi: il controllo dei risultati nella prospettiva economica aziendale,* Cedam, Padova, 1999.

company, positive variances are instead useful for the understanding of what path the company needs to follow in the future. As stated above, it is important for the management to determine and evaluate both intermediate and final results, but particularly intermediate results, because of the possibility to implement corrective actions whenever managers are doing something wrong or when the results do not fit at all what the budget shows. There are two main corrective actions that the corporate may adopt: the change of the working method followed by managers and business unit directors, and the modification of the programs – or of the objectives – defined during the planning phase.[126] The effectiveness of a corrective action is related to the accuracy and the punctuality with which the intermediate results have been achieved, the level of attention paid to the analysis of the motives that led to the determination of variances, and the promptness with which the corrective action has been implemented. Lastly, once the evaluation of the achieved results has been carried out and the eventual corrective actions implemented, the monitoring process is crucial. In fact, the corporate should make sure that the corrective actions have actually been implemented, and it should also monitor the effects brought about by those actions in the following periods.

In figure 2.8 it is possible to take a look at the summary of the management control process explained above.

[126] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

Figure 2.8 - Management control process phases



Adapted from A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.,* 2014.

In order to be effective, however, the management control process needs some specific requirements[127]:

- the material dimension of control, such as the supportive technical-accounting structure (budget and reporting) and the accountability map (responsibility centers and accountabilities), must be coherently defined by the corporate because they determine the overall functioning of the control process;
- the management control process must be coherent with the strategic planning process that precedes it;

[127] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

- the phases that lead to the completion of the control process must be carefully defined and implemented by virtue of the fact that every single-phase influences and is influenced by the correct functioning of the others;
- the control process must be defined by considering the unique characteristics of the firm in which it will be implemented, as well as the cultural level inside the firm itself;
- the control process must be shared out across the organizational structure;
- the control process must be flexible due to the dynamic nature of the firm's environment.

The fulfillment of the above requisites will allow complex organizations, primarily multinational corporations, to effectively manage and monitor their daily activities.

Before moving to the case study, there is still another aspect that results crucial for multinational companies: the corporate governance and the controllership.

Corporate governance represents the set of the existing relationships between the management, the board of directors, the shareholders and the stakeholders.[128] The term per se refers then to the system in which corporations are managed, and it is commonly used to highlight the differentiation between the propriety and the control of such corporations. In complex organizations corporate governance assumes an integrated characteristic that includes four distinct dimensions:

- the compliance, or rather the symmetry in terms of rules, principles and procedures;
- the performance, or rather the alignment between individual and strategic objectives;
- the risk, or rather the strategic risk management in terms of evaluation, management and control of the risk itself;

[128] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

- the knowledge, or rather the competences and the culture that characterize the company.

The majority of the corporations interpret governance as a system, a process, that communicates all information needed to guarantee a correct definition, execution and monitoring of the strategies to the key actors – such as the board, the CEO, the CFO, the top management and the shareholders. However, corporate governance processes and policies need to be accompanied by an adequate method of procedure in terms of compliance, performance measuring and internal business culture, which is generally included in the term "controllership".

Controllership is indeed a system aimed at monitoring the reliability of value creation for the shareholders (through the adoption of compliance policies), the integrity of the internal/external communication processes, the accuracy of planning systems, budgets and reports, as well as the identification of strategic risks.[129] These characteristics make controllership an essential coordination and corporate governance tool to stimulate the creation and rooting of a business culture aimed at achieving the best performances with integrity.

The need for the implementation of efficient and effective planning and control systems together with the need for managing the relationship between corporate governance and controllership, gave birth to a new job position, widespread today in almost every multinational corporation, the FP&A – i.e. the Financial Planning and Analysis.[130] The FP&A, alongside the CFO and the relative support of management control tools and processes, is accountable for tasks such as controllership, performance measuring, risk analysis, knowledge management and integration between business functions, and many other. Among these, the reporting activity implemented by the FP&A covers a crucial role due to its nature of connector between the management and the corporate; the reports provided by

[129] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*
[130] A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*

the FP&A, in fact, have the purpose to guarantee internal rules compliance and accountancy integrity in the eyes of the main stakeholders through the adoption of financial tools such as the turnover, the contribution margin and cost reduction.

Figure 2.9 - The role of the financial planning and analysis team

The role of the FP&A		
Controllership: the planning and reporting activities are fundamental to ensure financial statement integrity	**Planning & Measuring:** contribution margin, operating income, cash flow, and any other key financial measure help the management to align the board, the CEO and the CFO decisions	**Communication & Integration:** the measuring systems are fundamental to implement and optimize the "performance with integrity" rationale

Adapted from A. Riccaboni, C. Busco and E. Giovannoni, *cit. op.*, 2014.

CHAPTER 3
CASE STUDY: AVERY DENNISON RIS ITALIA SRL

The case study that will be analyzed in this section is a representation of the features presented in the previous chapters. Indeed, it perfectly matches the strategies and management control tools adopted by multinational corporations to succeed. This chapter starts with a short presentation of the company and its evolution – from a familiar business onto a multinational corporation – then, an analysis of the main tasks of the Finance Department will be implemented. A particular focus will be given to the cash pooling practice and to the principal reporting activities utilized as means of output control, characteristic of the role of the responsible for financial planning and analysis in a multinational company, whose actions and results are monitored by the financial controllers of the corporation.

3.1 History and organization of the company

To have a better view, it is important to start from the beginnings and explain the various steps which led to the creation of Avery Dennison RIS Italia SRL. The history of the current company is dated back in the 80s, when "Collitex", a small-sized and family-run textile manufacturing firm, was founded. The idea came from a garage in Colli del Tronto (province of Ascoli Piceno), where the owners started their own activity, which then developed into a real firm in Ancarano (province of Teramo) thanks to the aid of governmental funds "la Cassa del Mezzogiorno" (l. 10 Agosto 1950, n. 617). Since its beginnings, the company was specialized in the production of technical textiles.

Through the years, various acquisitions and creations of new business units have characterized the small sized firm, which grew really fast indeed; however, the first significant change happened at the turn of the 20th and 21st century, when the

company was entirely acquired by Paxar Italia SRL, in conjunction with the governmental funds' depletion.

The second radical change happened in 2007 when Paxar B.V. was acquired by Avery Dennison Corporation; the consequences of this acquisition were reflected on the company only in 2014, when the complete renewal of the small-sized Italian firm started. In fact, while Paxar Italia SRL agreed to do not alter the composition and production of the firm (Collitex srl was left as a distinguished entity when it was acquired by Paxar, while other divisions and local units took the name of Paxar), Avery Dennison imposed the merger by acquisition of all the entities which Paxar was composed of in order to obtain one sole unit.

Avery Dennison is an American multinational corporation operating in the field of manufacturing and global materials science; it is specialized in the design and manufacture of a wide variety of labeling and functional materials. The company is headquartered in Glendale, California, and at the moment it employs approximately 30,000 employees in more than 50 countries[131], from the United States to Europe and Asia. Reported sales in 2018 were $7.2 billion, in fact, it is also listed on the Fortune500® list of the largest U.S. industrial and service companies, at the 427th position. The company is organized following three business divided between two different divisions:

- Division "Materials" composed of
    - Label and Graphic Materials
    - Industrial and Healthcare Materials
- Division "Retail Branding and Information Solutions", or more easily, RBIS
    - Retail Branding and Information Solutions
    - Printer and Fastener Solutions

The division on which this case study is focused on, and consequently the main business of Avery Dennison RIS Italia, is the second one, Retail Branding and

[131] 400 of them are right now employed in Italy, in the business unit of the case study.

Information Solution. The vision leading this business is to create "Intelligent, Creative and Sustainable Solutions that Elevate Brands and Accelerate Performance Throughout the Global Retail Supply Chain"; the key players of the activity of the company are then designers, inventors, engineers, weavers, and other makers. Together, they create an ingenious team which provides the apparel and footwear industry with products, technologies, and solutions that defy the expected and reset the standard of innovation. At the same time, the company tries to maintain the highest standards of sustainability and ethics in everything that it does.

Before talking about the organization of the company, a presentation of its products is necessary. As stated above, Avery Dennison RBIS provides end-to-end solutions for the most exciting brands, prominent retailers and state-of-the-art manufacturers in the apparel and footwear industry. Thanks to the dimensions of such a multinational corporation, they are able to deliver breakthrough products with competitive prices and with a fast and flexible service to customers all over the world. The main solutions that it offers are:

- Apparel and footwear branding
    - External embellishments (such as fabric with reflective heat transfers, woven labels, patches, specialty trim, and so on)
    - Graphic tickets and tags (price tickets, size strip labels, pocket flashers, RFID[132] integrated solutions, pressure sensitive labels, and so on)
    - Packaging (minimal, recyclable packaging because of the commitment of the company towards sustainability)
    - Denim

[132] RFID integrated solutions are Radio Frequency Identification technologies aim at satisfying customer demand for supply chain optimization, increased visibility and improved inventory accuracy. RFID in fact, has the power to enable inventory accuracy in retail stores, facilitate last-minute inventory replenishment by reducing inventory and out-of-stocks, monitor product quality foods and supply pedigree data, provide an identifier to highlight counterfeiting returns, reduce shrink, enhance the omnichannel retail consumer experience.

    - Footwear
    - Team sports
- Apparel and footwear labelling
    - Compliance (to help companies entering a foreign market Avery Dennison provides global legal compliance labels; in this way, each country-specific profile includes relevant data sources such as laws and regulation, as well as national norms and standards. E.g. country of origin, languages, manufacturer/importer identity, and so on)
    - Care and content labels (such as care instructions, care symbols, fiber identity and content, size, and so on)
    - Price tickets and stickers
    - In-plant printings
    - Data management (web-based data management systems which ensure globally consistent products)
    - Brand protection
- Printer solutions
    - Tabletop and mobile printers
    - Handheld labelers
    - Proprietary labeling supplies

After the specification of the various products and solutions, it is also important to determine who those solutions are sold to. Hence, the main customers for Avery Dennison RBIS are apparel brand owners, retailers, and manufacturers, consumer goods manufacturers.

With regards to the organization of the multinational corporation, it is possible to say that Avery Dennison has a real complex structure, indeed it concerns an organigram which is a mixture of divisional and functional organizational structure.

In Figure 3.1. an example of the organigram is depicted: at the top of the organigram there is the president and CEO of the overall structure, from which different functions branch off. The main distinction is done in correspondence of “global” functions and “regional” functions; in other words, there are some of them that are developed globally, so they do not distinguish between regions, while others are developed and articulated according to the region of reference. More specifically, the functions Innovation, Payroll and IT are managed at global level and they do not make distinctions between RBIS and Material; functions such as Sales, Operations, Supply Chain, Human Resources and Finance are managed regionally and are distinguished between RBIS and Material. The organigram in fact, may be further split among the various levels of reports; an example of this split is depicted in Figure 3.2 where an example of the structure of Finance and Sales departments is represented.

Figure 3.1 - Corporate organigram

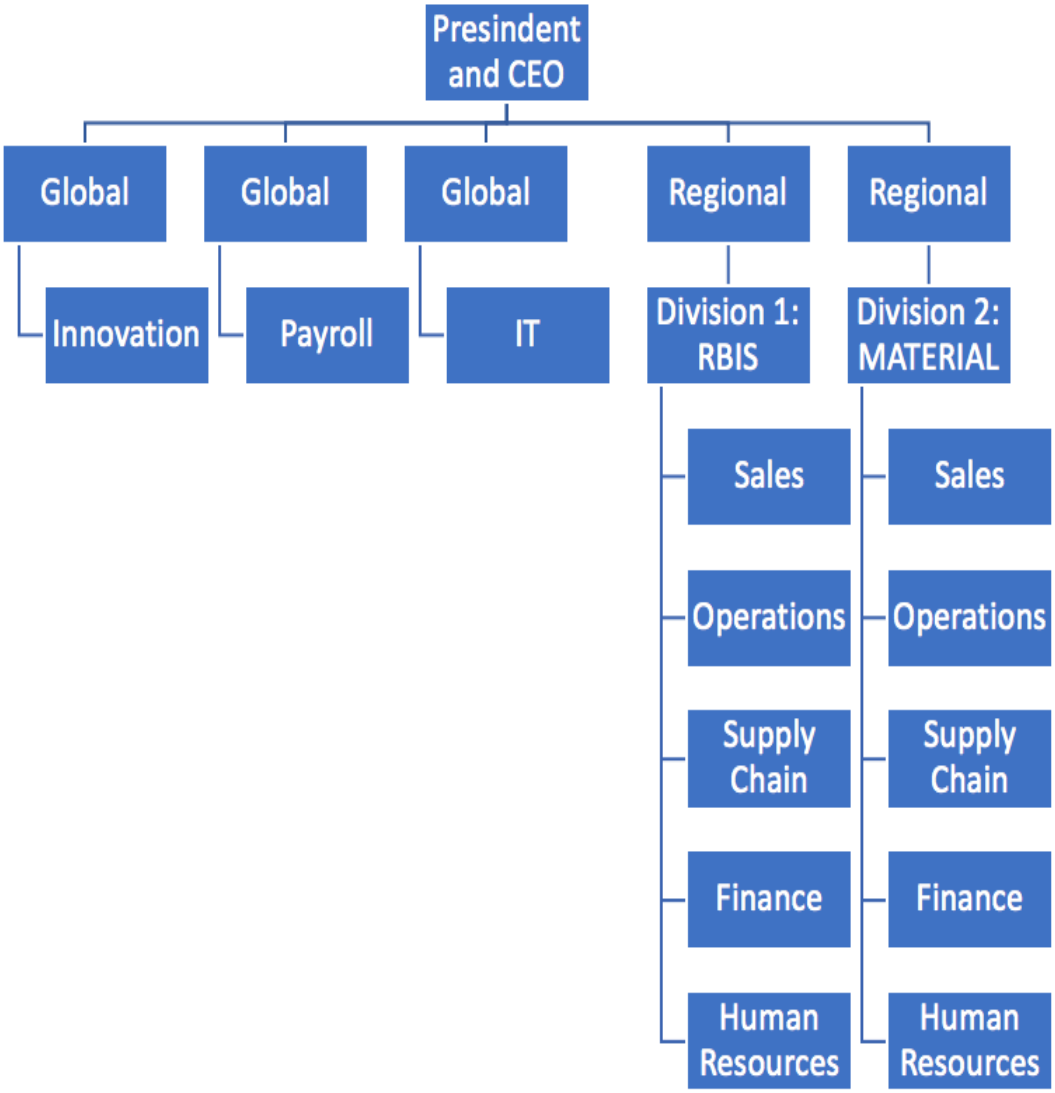
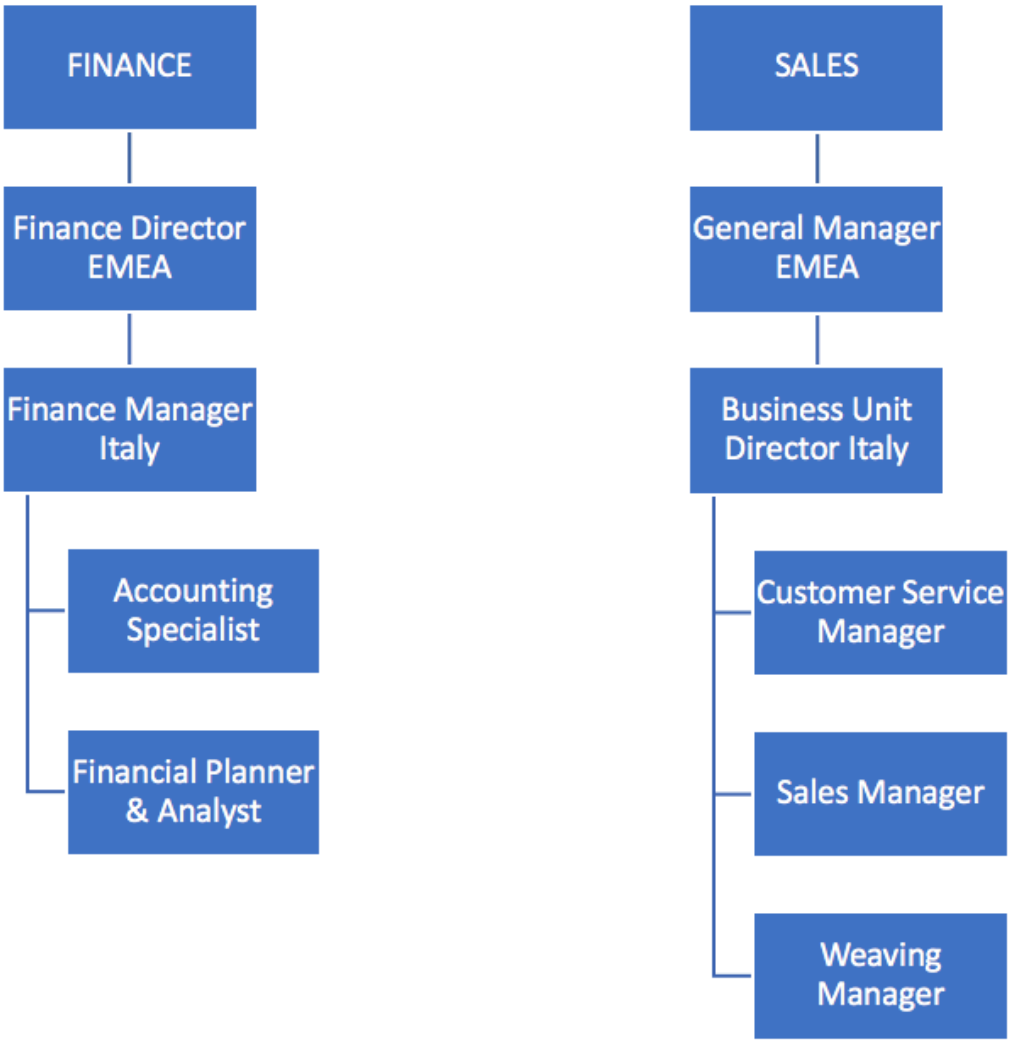


Figure 3.2 - Corporate organigram at lower levels of report



Before starting with the case study, a brief introduction to the ERP system used by the company will be presented.

An ERP, or Enterprise Resource Planning, is an integrated set of software modules covering a company's accounting, distribution, manufacturing,

purchasing, human resources, and other functions[133]. Real time information is collected in a single database and simultaneously fed into all of the software applications, giving personnel greater visibility into the company's end-to-end business process.[134] Indeed, ERP systems are utilized to manage and coordinate the activities of different departments in the company; it helps them to communicate and share information more easily with respect to the rest of the company by collecting information about the activity and state of different divisions, making this information available to other parts, where it can be used productively. Because of the ability of the software to connect different technologies used by each individual part of a business, an ERP application can also eliminate costly, duplicate and incompatible technology. Some of the most important functions of ERP systems are:

- to perform accurate calculations;
- to simplify the budgeting activity;
- to keep track of the standard, average and actual cost of items in inventory;
- to make real-time assessments of variances;
- to integrate the sales process, from the creation of the purchase order, passing through the invoice issued, and the production process (stock control, schedule of procurement, manufacturing, inventory, shipment), and arriving to the finance department where the credit of the salesperson (with his or her commission), all the production costs and the other financial accounting information are entered in the system.

In addition to that, the ERP system allows the company to shift its manufacturing and distribution plans rapidly in response to changes in supply and demand. However, the implementation of a suitable ERP system is very complex, especially because it must be elaborated on the basis of the characteristics and needs

[133] C.T. Horngren, S.M. Datar, M.V. Rajan, *cit op.,* pp 779.
[134] C.T. Horngren, S.M. Datar, M.V. Rajan, cit. op., page 780.

of the company; for this reason, ERP developer companies are customizing the software according to the company's needs, and they are providing them with the best technical support.

Oracle11 is the ERP system used by Avery Dennison[135], in particular, the finance department, which is the main protagonist of this case study, utilizes "Hyperion Financial Management" that is a comprehensive, web-based application that delivers global financial consolidation, reporting and analysis in a single, highly scalable software solution. Oracle Hyperion Financial Management utilizes today's most advanced technology yet is built to be owned and maintained by the enterprise's finance team (in fact, it is customized according to company's needs).

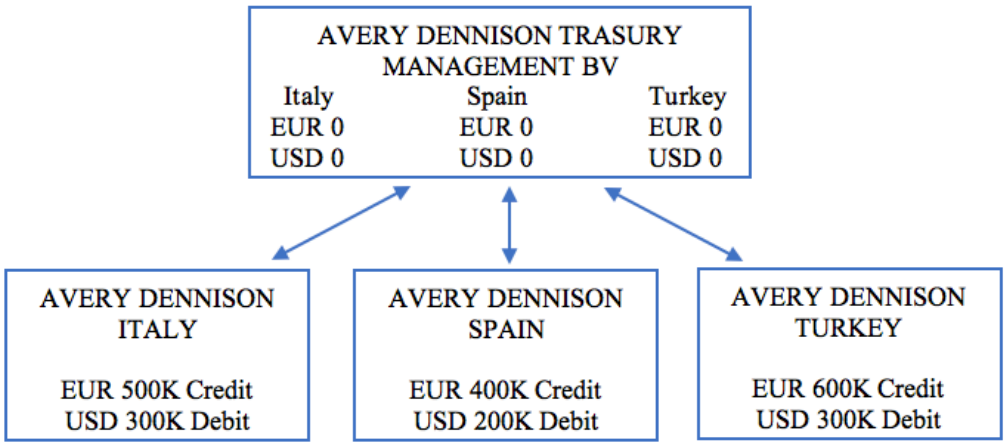
3.2 Cash pooling

Cash pooling is a cash management strategy whose objective is to bring together credit and debit balances of the same corporation, creating a "pool" of bank accounts. The pooling in fact, is usually accomplished through the arrangement of "bank account structures that mimics corporate accounting treatment and offsets cash deficits with cash surpluses between different legal entities in a corporate group"[136] and for this reason, it is a very common tool among multinational companies to effectively manage global liquidity, simplify bank account structures and reduce overall bank transaction costs. Among the benefits offered by cash pooling, indeed, the main ones are those concerning the improvement in interest charges[137], the simplification of cash management procedures and the increase in liquidity. There are two alternative approaches to cash pooling, the notional pooling

[135] Oracle11 is the one used by Avery Dennison RIS Italia, but they are shifting to Oracle12 as the majority of the subsidiaries of the multinational companies.
[136] S. Hillman, Notional vs. Physical Cash Pooling Revisited, *International Treasurer*, Treasury Alliance Group LLC, February 2011.
[137] Improvement in interest charges concerns the annual reduction in interest paid or increase in interest received, which results from netting credit and debit balances.

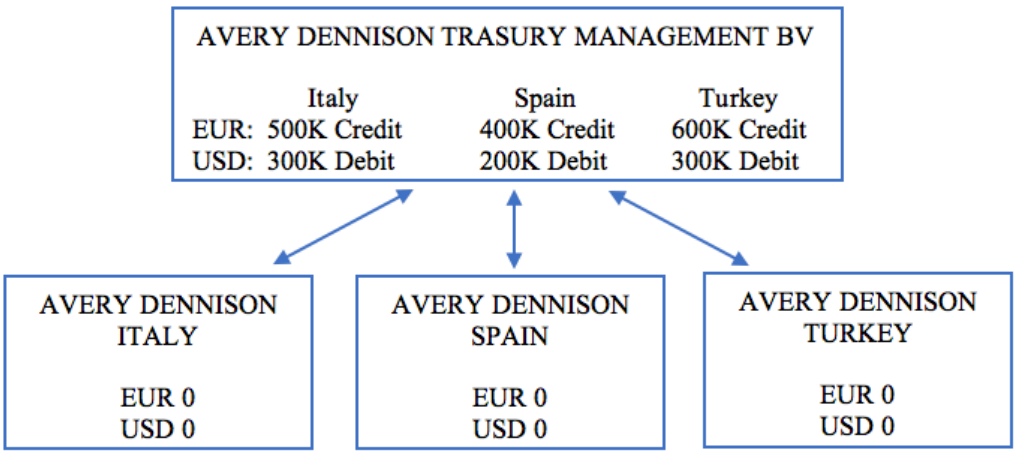
and the zero-balance pooling (or cash concentration). The notional pooling provides the notional offsetting of multiple balances for the purpose of calculating interest on the net balance, with this technique there is no physical movement of funds between participating accounts. The zero-balance pooling, which is the focus one in this case study, provides instead the physical movement of bank account funds, in fact, at the end of the working day, all the final positions of the various business unit's bank accounts are brought to zero and flow into one single bank account[138]. Avery Dennison collects the credit and debit balances of its subsidiaries in a treasury management company, or rather an entity created with the sole aim of managing the liquidity and mitigating operational, financial and reputational risk. In figures 3.3.A and 3.3.B it is possible to take a look on the functioning of the Zero Balance cash pooling practice.

Figure 3.3.A - Zero Balance cash pooling position at the beginning of the working day



[138] i.e. a cash concentration account which usually is denominated "cash pooling account".

Figure 3.3.B - Zero Balance cash pooling position at the end of the working day



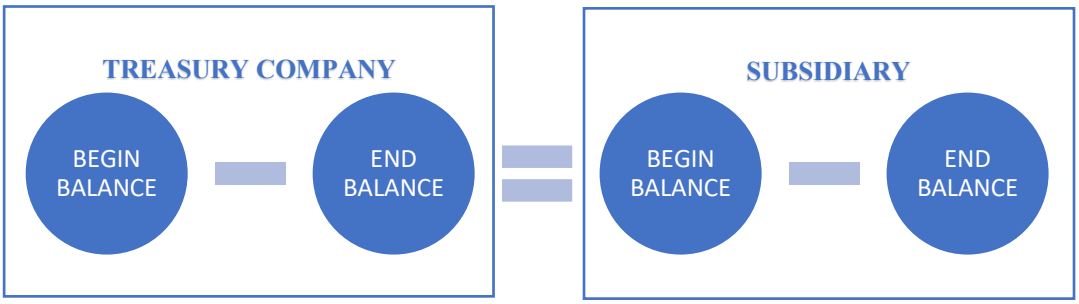
As it is possible to see from the two graphs, the treasury management company keeps the cash pooling accounts of each business unit distinguished, in order to monitor their liquidity position. Indeed, the cash pooling practice may be considered as a form of control of the parent company with respect to its subsidiaries. The most important aspect to understand in this particular case is that bank accounts of each business unit are divided between two main positions:

- a bank account in Euros and US Dollars which goes to zero every day at the end of the working day;
- a deposit which is recapitulative of the overall situation of liquidity, both in Euros and US Dollars, and which never goes to zero (cash pooling account).

These two positions, both in Euros and US Dollars, present an aspect to point out: the US Dollars are always borrowed by the holding company. This means that the USD position corresponds to a loan granted by the treasury management company (which corresponds also to a bank account with a debit balance) on which every business unit must pay regular interest and which is periodically compensated with the bank account position (credit balance) in Euros. Monthly bank accounts of each

business unit must be in line with the ones of the treasury, the check is made with respect to a prospect called "Intercompany Loan Statement", sent by the treasury, on which every subsidiary verifies that its own end balance is equal to the one presented by the treasury. The comparison, hence, is made between begin balance and end balance of both prospects:

Figure 3.4 - Balancing of pooling accounts



The following operation is named "Cash pooling balancing of accounts", and it consists in the further check of potential errors: once the two balance positions have been analyzed, the additional balance sheet accounts left out of the respective bank statements are reversed in a transitory cash account and consequently closed (brought to zero), if any error is encountered, the procedure provides to correct that mistake and then proceed to the closing of the period[139]. For instance, by having bank account positions in two currencies (EUR and USD), one common error resulting from the ordinary course of the business is to register a transaction in Euros rather than US dollars, and vice versa. More specifically, if the mistaken

[139] It is important to remember that American companies are asked to draw up the financial statement on a monthly basis. As a consequence, the Italian subsidiary of Avery Dennison will have to do the check of the bank accounts resulting from the balance sheet account drawn up according to the US Gaap, which follows the "Avery calendar" of the 4-4-5 (one year composed of four quarters composed of months with 4 weeks, month 1, 4 weeks, month 2, and 5 weeks, month 3).

entry consists in a money transfer[140] of bank charges in the USD pooling account rather than in the EUR pooling account, an adjusting entry would be necessary. This latter would consist then in a further money transfer from the USD pooling account to the EUR one. After all the corrections have been processed, the cash pooling balancing of accounts may be concluded with a few ultimate steps: first of all, the money transfer to the treasury pooling account in US dollar and Euro; secondly, the journal entry of gains or losses on foreign exchanges; finally, the journal entry of positive or negative interest charged by the treasury. Last but not least, one final aspect to consider concerns the potential losses deriving from the utilization of the two currencies. The corporate has indeed created a tool to monitor and limit the potential impact on earnings resulting from foreign exchange rate fluctuations, which is named "Hedge" and is mainly applied on the debt balance position of the account in US Dollars. The hedge system provides a sort of dollar buying and selling from the treasury, which allows to get a foreign rate impact contrary to the one that will be realized the subsequent month (so that the impact will be netted); the amount is determined on the basis of what has been communicated by business units in a specific forecast template called "Balance Sheet Foreign Exchange Exposure". Usually, the main exposures are given by:

- fair value exposure – i.e. a foreign exchange exposure resulting from a recognized asset/liability or of an unrecognized firm commitment – including Transaction exposure, resulting from foreign currency accounts receivable and payables which are subjected to changes in value due to movements in exchange rates;
- forecasted earnings or cash flow exposure, or rather the anticipated future earnings or cash flows that could be affected by changes in foreign exchange

[140] Here, the term "money transfer" or "bank transfer" is used because due to the presence of cash pooling practice, the subsidiary does not have the authority to pay directly, it must always use the pooling accounts.

rates that may not be eliminated by management's operating decisions (e.g. anticipated revenues, collections and payments);

- counterpart risk exposure, or rather the risk that a bank with whom the company has entered a foreign exchange trade fails to meet its settlement obligation.

After the main exposure risks have been analyzed, financial analysts will search for the information on the balance sheet related to the items entered with foreign currency (which in this case are those in US Dollars), in this way, it will be possible to fill the B/S Foreign Exchange Exposure template. The main balance sheet account items to consider for the compilation of the template are:

- trade receivables (in USD);
- intercompany receivables (in USD);
- trade payables (in USD);
- intercompany payables (in USD);
- the debt towards the Treasury Management Company (in USD);
- the amount of the Hedge imposed by the treasury management company on our behalf (in USD);
- other potential account items in USD.

To what it concerns trade/intercompany receivables and trade/intercompany payables, these data are furnished by the ERP system, Oracle, which through the extrapolation of reports for accounts receivables (projected gains and losses report) and payables (unrealized gains and losses report) is able to estimate and write down the impact of foreign exchange on debts and credits. With regards to the account payables, however, it is necessary to consider not only the ones automatically entered, but also those adjustments regarding "goods in transit" and "goods received not invoiced".[141] Further on, the value of the debt towards the treasury

[141] Goods in transit refer to all those items that have been expedited from the suppliers but have not physically arrived; they need to be considered because of the incoterm "ex works" which provides

management company is monthly provided from the bank statement sent by the treasury itself. Finally, the amount of the hedge determined – and consequently imposed – by the treasury both in actual value, for the current month, and in forecast value for the subsequent month. The calculation in this case is made on the basis of the balance between all the credit and debit positions in US Dollars that the business unit communicated the prior month. After all this information are provided, the template may be filled in; however, the B/S Foreign Exchange Exposure template contains "actual" and "forecast" values, consequently, an estimation of the forecast data is needed. The estimate for the months following the reference month may be divided between the abovementioned account items:

- trade receivables and payables are determined on the basis of credit collection and debt payment expiring dates, on the basis of expected future sales and future costs (generation of new credits and debits), plus other corrections on the basis of the month in which the template is filled[142];
- hedge amount is based on the value communicated by the treasury the month before, as explained above;
- debts towards the treasury management company in USD is subjected to increases or decreases on the basis of the various movements (cash in and cash out) of trade receivables and payables in USD.

At the end of the template compilation process, the value of gains and losses on foreign exchange of the Hedge should be able to compensate the value of gains and losses deriving from trade receivables/payables plus the debt towards the treasury. In table 3.1 an example of the monthly foreign exchange exposure is provided.

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the automatic transfer of propriety from the supplier to the client (the company in this case). Goods received not invoiced instead, are those items which are physically present in the warehouse, but the relative invoice has not been issued yet, for this reason they need to be considered in the calculation.

[142] For instance, in presence of risk clients such as those who have an expired credit of more than 90 days financial analysts will make some corrections because they know that probably they are not going to cash that credit in. In addition to that, some corrections may be due to particular year periods such as Christmas, Easter or summer vacations and in correspondence of those periods some credits or debts may shift from one month to another one.

Table 3.1 - Monthly foreign exchange exposure (example month of February)

Account Description	Account Type	Actual	Forecast →										
USD	Asset Type	J	F	M	A	M	J	J	A	S	O	N	D
		Prior month	Current month	+1	+2	+3	+4	+5	+6	+7	+8	+9	+10
Trade receivables	Asset												
Intercompany receivables	Asset												
Trade payables	Liability												
Intercompany payables	Liability												
Pooling account vs Treasury	Asset												
Hedge loans and contracts	Asset												
Other accounts	Asset												
Net balance sheet exposure	US Dollars												

3.3 The financial reporting activity

The main focus of this final part of the case study concerns the role of corporate financial planning and analysis, or rather on financial accounting, which is focused

on reporting financial information to internal management and to external parties such as investors, government agencies, banks, and supplier based on Generally Accepted Account Principles (GAAP). Indeed, the aim of the responsible for this task is to provide an accurate outlook of the company's financial metrics to key stakeholders as well as to provide an analysis of the company's performance against the financial plans and strategies. In order to do that, there are several core activities to accomplish, such as, the development of quarterly, annual and long-range financial forecasts, the development and management of functional and operational expense budgets, the analysis on variances to the financial plan and strategy, the annual balance sheet review program (together with the corporate controller), and finally, the quarterly attestation process for corporate reporting.

1) *Flash & Forecast,* it is a prospectus which works as primary tool for the controlling activity of the corporation. There are various detailed reports that are connected to and must be in line with the information contained in the Flash. These are:

- *RBO Forecast* (sales by main RBO customers per month)
- *Sales & Contribution Margin* (sales by product category with the related CM per month)
- *Opex* (operating expenses by expense category per month)
- *Working Capital and Free Cash Flow Variance* (variances analysis of the main items of balance sheet)
- *Capex Tracker* (capital expenditure per month, on the basis of the effective payment of the asset)
- *Saving Tracker* (plan of activity to reduce costs, per month)
- *MBR and QBR* (analysis with general comments to present a summary of monthly and quarterly results at upper levels)

2) *Balance Sheet Review*
3) *Quarterly attestations*

The reports emerging from the Finance Department every month derive from a very precise schedule that the corporate imposes on its business units. The responsible for these reports is the Financial Planning & Analyst and his monthly activities may be synthetized as follows:

Table 3.2 - An example of a Financial Analyst deadline calendar

MONTH "X"				
WEEK 1				
Monday	Tuesday	Wednesday	Thursday	Friday
	• FLASH (definitive) • RBO Forecast		• SAVINGS TRACKER	• CAPEX TRACKER
WEEK 2				
Monday	Tuesday	Wednesday	Thursday	Friday
• OPEX **• SALES & CM** **• RBO Forecast Actualization** **• MBR/QBR**				
WEEK 3 or 4				
Monday	Tuesday	Wednesday	Thursday	Friday
			• BALANCE SHEET REVIEW	
WEEK 4 or 5				
Monday	Tuesday	Wednesday	Thursday	Friday
	• RBO Forecast • FLASH (prevision)			

1) The Flash and Forecast

The "Flash&Forecast" represents the main report due to its completeness of information. Indeed, it is a projection of *sales*, *costs* and *working capital*. The peculiarity of this file is the form under which data are shown since they are divided among "Actual", "Forecast", "Annual Operating Planning" (AOP) and "Previous Year". Filling this report in is a mandatory activity in each RBIS business unit of each region; in this way, the corporate can have a global view of business unit performance. Data exposed on the Flash are mainly the results of the Financial Statement (sales and costs are data displayed from the Profits&Losses while working capital shows data from the Balance Sheet), as per the previous months, while the other data are projections or forecasts of the subsequent months.

The Flash works entirely on Google Drive where it must be updated monthly, however, data coming from the Drive must be re-elaborated on a specific formal template (see Figure 3.5) in Oracle Hyperion Financial Management where it must be officially submitted quarterly (see Figure 3.6). Hence, the official template is updated with monthly data derived from the Flash, in this way, it may be automatically submitted on Hyperion, where the final data are available for everyone in the company. The entire template is composed by balance sheet account items for each quarter, for each month of the selected scenario. To make an example, assuming that the financial analyst is filling the report in Quarter 2, Week 1 of April 2019, he will have the:

- entire PREVIOUS YEAR (with data from January to December of 2018);
- entire AOP (with data from January to December of 2019 established during the budget formulation);
- first quarter filled with ACTUAL data (with real data of January, February and March 2019);

- prediction and adjustments of the 9 months afterwards with FORECAST data (or rather data from April to December 2019).

Figure 3.5 - An example of the official template before the upload on Oracle Hyperion Financial Management, April 2019. The interface is very heavy due to the amount of information it contains (from the Balance Sheet to the P&L account). It is directly connected to the Flash&Forecast file, consequently it automatically updates all the information reported there

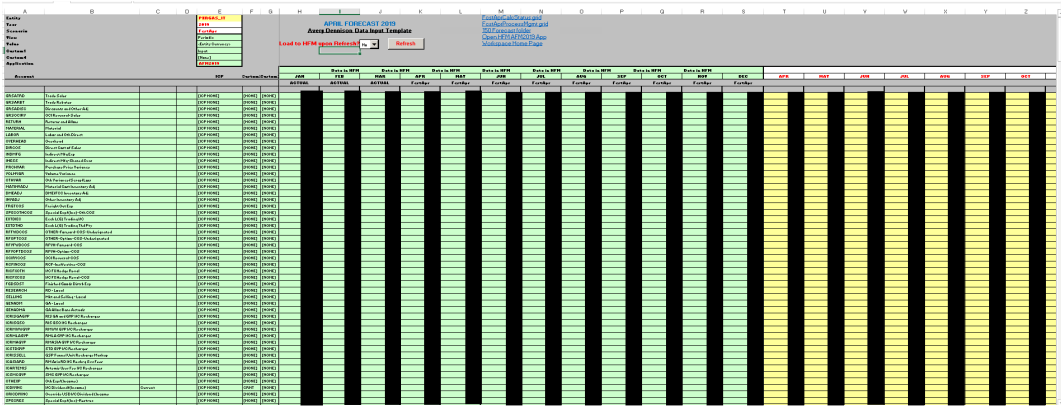
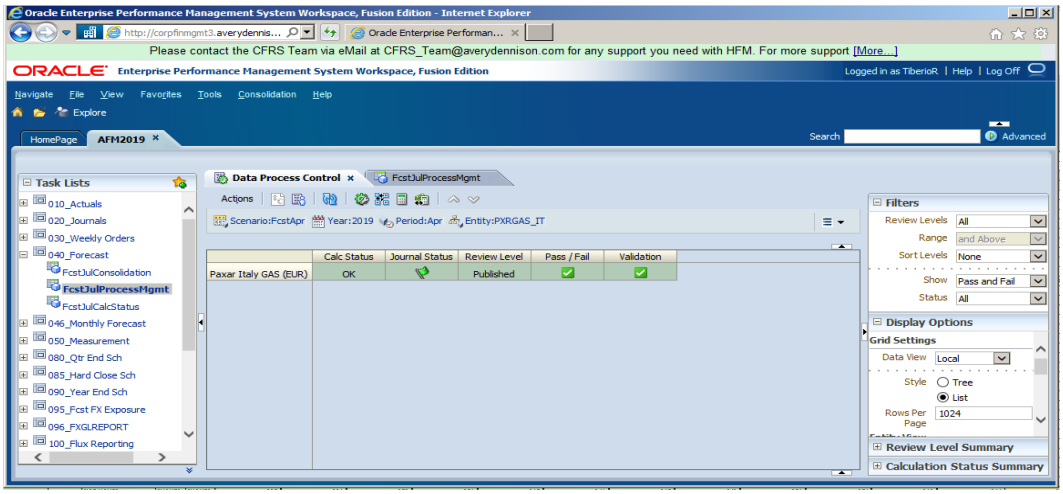
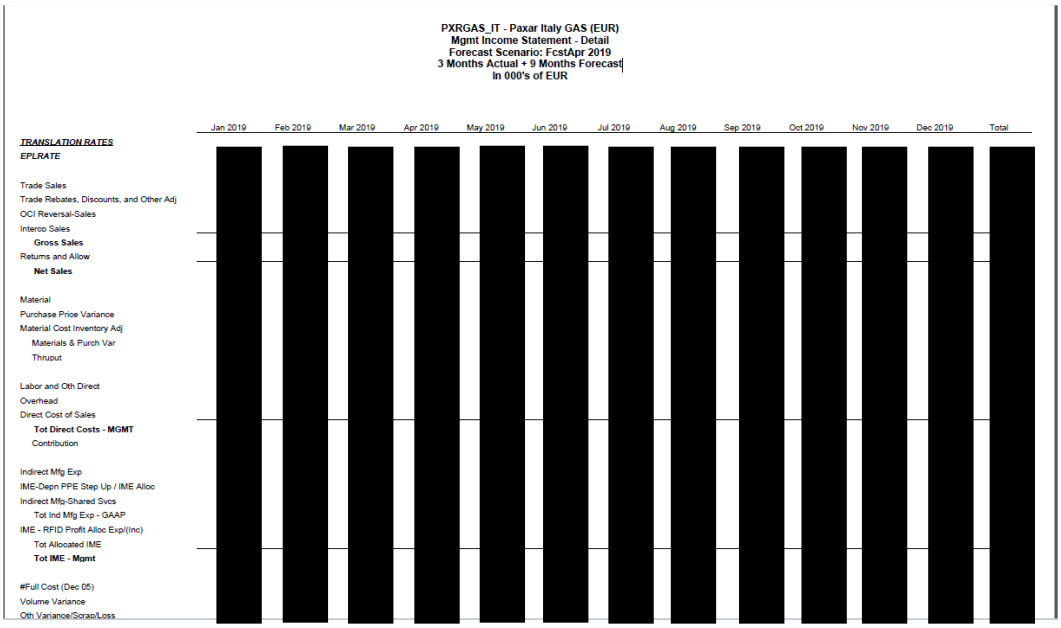


Figure 3.6 - An example of the upload of the official template on Oracle Hyperion Financial Management, April 2019: the upload has been positive, in fact, all the information encounters a "green flag"



Subsequently to the uploads on Oracle Hyperion Financial Management, it will be possible to extrapolate the single reports which may result whether by the balance sheet submissions or by the official template submission (an example of the income statement report is available in Figure 3.7). These are the reports that will be presented to the financial controllers which will then make their considerations and analysis about the results as well as the compliance between the data presented on the Flash and the final results.

Figure 3.7 - An example of P&L account resulting from Oracle Hyperion, April 2019: 3 months are actual data while the 9 months afterwards are forecast data



Going more in-depth, there are two major updates in Flash&Forecast, even though it is always necessary to adjust the numbers each time the finance team becomes aware of some variances. As shown in Table 3.1, the first update is due by the end of the month (Flash → Prevision), where by month is intended the

calendar configuration following the 4-4-5 rule. In this occasion, the focus is on data previsions of the closing period, particularly in terms of sales and costs. The second update (Flash → Definitive) is due by the first week of the subsequent month (so, first week of the month according to the 4-4-5 calendar). In this case, the focus is on the final numbers of the closing period, or rather the actual numbers of the Financial Statement – at least as close as possible to the actual numbers. By all means, it is always possible to change and update the files on the Drive, especially in terms of forthcoming month forecasts, before submitting it to Hyperion.

In Table 3.3 a configuration of the Flash&Forecast is depicted. Starting from the first part of the prospectus, "Sales" deriving from the income statement is the first item; these are differentiated between "Outside Sales" and "Intercompany Sales", which are themselves divided according to the area where the sale took place (EMEA, i.e. Europe Middle East and Africa, and ASIA/US). By subtracting the direct costs (in this occasion direct costs are composed by material, labor and overhead costs) it is possible to get the Contribution Margin. Contribution Margin provides one way to show the potential profit of a particular product or line of product; in addition to that, it shows the portion of sales that helps covering company's fixed costs, in this way, any remaining revenue left after fixed costs have been covered is the profit generated. This is a relevant point for the final report, especially due to the fact that one of its functions is to provide financial managers and controllers with explanations about the changes in Contribution Margin. Here comes the need for a subdivision of information after its calculations: any kind of variation in the Contribution Margin must be justified on the basis of "volume variations" and "non-volume variations". The former entails variations which are strictly related to sales volume, while the latter entails variations which are not strictly related to sales volume, in fact, these may be related to external factors (credit notes, price variations, warranty replacements, and so on) or to the presence of fixed costs (labor cost for example). Moving on with prospectus,

another significant item is represented by indirect costs. Indirect costs are subtracted from the contribution margin and they are composed by manufacturing operating expenses (MOE) which are obtained by summing:

- Indirect Manufacturing Expenses (IME), or rather all the indirect costs that are related to the production such as machinery amortization, maintenance, electricity, and all those employees who are part of the "Operations Department" such as those of the "Supply-chain", "Production Planning", "Procurement" and "ELS" (production control engineering) offices;
- Inventory adjustments, or rather all those adjustments related to obsolescence provision (on the basis of the company's policy) as well as all those unexpected differences on the inventory that need to be adjusted;
- Freight out[143], or rather the shipping costs sustained to expedite the orders;
- FGDE, or rather the costs of the shipping department (such as packaging costs or employee costs);
- Foreign exchange, or rather all the costs that derive from differences in the exchange rates, always connected to commercial consignments.

The subsequent point is the Gross Profit, which basically represents the profit the company makes by deducting the costs of producing and selling the products but without considering fixed costs, and it serves as a sort of business unit efficiency assessment (in terms of labor usage and production process stages). The gross profit is the step before the deduction of indirect costs; here, the focus is on those costs that are considered as fixed. In the Flash&Forecast there is a main distinction: SGA and Allocations GSP. SGA is the acronym of "Sales, General and Administration", or rather the costs of staff functions such as the finance department, the human resources department, the sales department (customer service and sales), the IT department, but also the amount of office material and immaterial goods

[143] Concerning the Freight In costs, these costs are not present here because they are included in direct costs, specifically under "Material" voice.

depreciation is included. With regards to Allocations GSP[144], these are a sort of costs allocation, in other words, due to the fact that the company is a business unit located in another country, the holding imposes them to allocate their main costs to one company and then distributes these costs across all the business units in reference proportionally to their business dimensions. In this occasion, the costs debited by the corporation is included among the "other indirect costs".
After the deduction of other indirect costs, the EBIT (Earnings Before Interests and Taxes or Operating Profit) is displayed; in this way, the company has a vision of the profit generated by operations, ignoring taxes and capital structure variables. The EBITDA (Earnings Before Interests, Taxes, Depreciation and Amortization) comes right after by adding Depreciation and Amortization expenses to EBIT.

Moving on, the second part of the prospectus emerges: the working capital. Working capital measures company's liquidity, operational efficiency and the short-time financial health. However, in this part of the controlling process working capital is not determined and completely shown, data are only reported to have a check and a prevision of the numbers, just as the data above, coming from the income statement. Starting from "Trade Receivables", they show the amounts billed to the customers of the company for the delivery of goods and services. In this case, they are considered at net of the Bad Debts Reserve. The second element of the working capital is the "DSO", which is the acronym of Days Sales Outstanding or Days Receivables; it is an index which measures the time, in terms of days, needed for the company to cash in commercial credits, or trade receivables (once the invoice has been issued). It is given by the relationship between "Accounts Receivables" and "1 day of trade sale" (calculated on the basis of "adjusted trade sales" in a 3-months period). The next item is represented by "Total Inventory Net", which basically is the gross inventory (composed by raw material, work in progress

[144] The GSP is a system created in Avery to allocate and distribute the main costs of the group among the various business units across the world: the division is made every quarter on the basis of the dimension of the business unit itself.

and finished goods) net of the inventory reserve[145]. "Inventory Turns" comes right after, and it shows the relationship between Total Inventory Net and Cost Of Goods Sold[146], in other words, how many times the company is able to rotate (or renew) the warehouse. "Total Trade Payables" represents the contrary of total trade receivables, in fact, it is the amount billed to the company by its suppliers for goods delivered or to service consumed during the ordinary course of the business (it basically refers to GRNI, Goods Received Not Invoiced, and Accruals for GRNI). Finally, "DPO" that is the acronym of Days Payable Outstanding or Days Payable and it is an index which measures the time, in terms of days, needed for the company to pay back its commercial debts (or trade payables). It is given by the relationship between "Accounts Payable" and "1 day of direct cost" (calculated on the basis of "total direct costs" in a 3-month period).

Last but not least, it is important to stress that the data on the flash are the results of predictions based on previous year and budget data. For this reason, in order to fill the above mentioned prospectus, there is a specific table in which it is possible to do the predictions: by adding the account voices in reference and modify the numbers, the action will be immediately reflected on the corresponding item in the Flash, the numbers will be summed with data from the previous year, and it will be suddenly possible to see their overall impact and decide whether those predictions are suitable or not.

[145] The inventory reserve is determined according to the firm's inventory policy; in this case, it is based on the degree of obsolescence of the goods in inventory.
[146] Inventory turns is given by the annualized value of the last 3 months of both total inventory net and cost of goods sold. Once determined, it expresses the inventory turnover but referred to 1 year.

Table 3.3 - Configuration of the Flash&Forecast file

ITALY – Forecast April		ACTUAL / FORECAST						AOP			PREVIOUS YEAR		
		Q1			Q2			Q3			Q4		
		J	F	M	A	M	J	J	A	S	O	N	D
PROFITS AND LOSSES													
A) SALES	• Outside sales												
	• Intercompany sales - EMEA (Intra Regional) - ASIA / US												
B) DIRECT COSTS	• Material												
	• Labor												
	• Overhead												
C) CONTRIBUTION MARGIN (A-B)													
D) INDIRECT COSTS: MOE (Manufacturing Operating Expenses)	• IME & Variances												
	• Inventory Adjustments												
	• FGDE												
	• Freight out												
	• Foreign Exchange												
E) GROSS PROFIT (C-D)													
F) OTHER INDIRECT COSTS	• SGA (Sales General Administration)												
	• Allocations (GSP)												
G) EBIT (E-F)													
H) D&A	• Depreciation												
	• Amortization												
I) EBITDA (G+H)													

WORKING CAPITAL	
	TRADE RECEIVABLES
	DSO
	TOT. INVENTORY NET
	INVENTORY TURNS
	TOT. TRADE PAYABLES
	DPO

After the above explanation of the Flash&Forecast report file, it is necessary to show also the main detail files which explode the information it contains.

The RBO Forecast

The first one is the RBO Forecast file, where RBO stands for Retail Brand Owners, that is the appellative given to those customers who detain the brand property. In order to understand their role, it is important to comprehend a basic concept: due to the peculiarity of RBIS business, Avery Dennison does not sell its products directly to final customers, it sells to "vendors". These are those figures who work for or produce for big brands; in jargon they are called "Bill To" because they are the addressees of issued invoices as well as the receivers of the goods. Now, due to the elevate number of vendors, and due to the fact that every country has its own vendors, the policy of the company is to merge these vendors, and identify the owner of the brand as "Customer Retail Brand Owner", which in jargon is named also "Sold To" to categorize the real owner of the brand. To make an example: a company Alfa S.p.A purchases nr. 300 woven labels Nike. Alfa S.p.A will be the company who receives the invoice and the woven labels (bill to), however, in sales analysis this movement will be identified under the RBO Nike (sold to).

The RBO Forecast is a significant report because it provides the Flash&Forecast file with information about the sales (voice A of Table 3.3), indeed it consists of a sales projection differentiated between “Trade Sales” and “Intercompany Sales” (which will then create the voices differentiation between EMEA intra-regional sales and ASIA/US intercompany sales). Just as the Flash&Forecast, the RBO Forecast shows data according to ACTUAL and FORECAST data, PREVIOUS YEAR data and AOP data. Concerning previous year and actual data, they result from the sales reports generated by the ERP software, while forecasts and budget values are estimations resulting from the previsions that sales analysts and managers do at the beginning of the period. In Table 3.4 it is possible to see an example of how the RBO Forecast is structured; the first column is dedicated to the retail brand owners, such as Nike, H&M, and so on. The second column shows the quarterly contribution margins for each RBO, which result from another quarterly report. The third column depicts more detailed information because it shows a direct comparison (month to date or quarter to date) of the sales in the selected scenario with those of the previous year and those of the annual operating planning. Then, monthly/quarterly sales are projected and differentiated according to actual and forecast results. As per the following column (due to lack of space the bridge is shown on Table 3.5), the “Bridge” represents the result of RBO Forecast actualization: once the sales amount have been uploaded by each business unit on the file, financial controllers extrapolate and analyze the real detailed numbers resulting from actual sales, and they update the RBO file. Most of the times, differences between data uploaded from business unit analysts and data from financial controllers will emerge, at this point, financial controllers will ask explanations about those differences and these explanations will have to be shown in a specific table in the RBO file. Due to the elevated number of RBOs, financial controllers at upper management level impose financial analysts to report only those who experience significant sales variances. In order to do this, a threshold of

50.000$ per month has been established, however, this level seems to be too high in some cases, and it does not permit to have detailed information about the variances themselves, for this reason it has been allowed to show also those variances that are lower than the threshold. In any case, differences resulting from forecast and actual data have to be shown in the tables, together with their "reason code", represented by the columns in yellow[147].

An additional data that business unit financial analysts may put in the RBO Forecast file is the collection of possible risks and opportunities per RBO per month. Risks and opportunities are generally attributed to those customers who have historically presented some problems – such as a cancellation of their order or a missed order after a long negotiation process – or, on the contrary, those who represent a future opportunity – such as a new client or an ongoing negotiation. This information will not have any impact on the main table, because it has not been verified, however, it may be useful for financial controllers to analyze final numbers and make future predictions.

[147] Sales differences may be caused by different reasons. Here, the main ones are: organic growth (or decline), due to natural market conditions; migration, due to clients movement to/from other business units; price, due to change in prices deriving from commercial negotiation; mandate business win (or losses), due to the acquisition of a new client; phasing, due to order shifts that may or may not depend on the business unit; multi-business win (or loss), due to the acquisition of diverse typologies of products from the same new client; one timer/other, due to occasional motives and any other reason not mentioned above.

Table 3.4 - Configuration of an RBO Forecast file

ITALY (Fcst April)	CM% 2018		QTD or MTD (March)		ACTUAL / FORECAST						AOP			PREVIOUS YEAR						
RBO	Q1	Q2	Q3	Q4	J	F	M	Q1	A	M	J	Q2	J	A	S	Q3	O	N	D	Q4
Nike																				
H&M																				
Lacoste																				
...																				
Total Trade Sales																				
Intra-regional Sales																				
Intercompany Sales																				
Grand Total																				

Table 3.5 - The Bridge

ITALY (Fcst April)	BRIDGE										
RBO	AOP for May	Organic Growth	Migration	Price	Mandate Business	Phasing	Multi-Business	One timer/ Other	TOT	June Fcst for May	Actual VS Fcst
Nike											
H&M											
Lacoste											
...											
Total Trade Sales											
Intra-regional Sales											
Intercompany Sales											
Grand Total											

The Sales & Contribution Margin

The second detail file is given by the "Sales&CM", that is, Sales & Contribution Margin. This file has a dynamic nature because it consists in a process of updating forecast data, in fact, it shows the amount of sales and contribution margins according to product category, which should always be in line with the Flash. This file is useful to have an additional view of the sales, which this time are split among product category. It is important to understand that changes in this file are always in line with the variations shown in the RBO Forecast file. Indeed, on the basis of the RBO client and its variance, financial analysts are able to understand which category should be modified by consequence[148]. In order to have a clear view of the various stages of Sales&CM file compilation, analysts usually have a first check of each RBO description, assign it a product category, and then see how to modify data. In table 4.6 an example of Sales&CM is displayed; even in this report data are differentiated between Actual/Forecast, AOP and Previous Year. As mentioned above, the prospectus shows outside sales and intercompany sales by product category, as well as the relative contribution margin, which is displayed both in percentage and dollars. On top of the table, there is a small prospectus in which discrepancies with respect to the Flash&Forecast file emerge, in case there are any of them. In order to be correct, these differences must not exist, in other words, they should always be equal to zero.

[148] Because affected by real variance data in the RBO file. However, it may be also possible that information coming from the sales department are with regards to product categories and not to retail brand owners; in this occasion, it is the RBO Forecast file which follows (and will need to be updated) the Sales&CM file.

Table 3.6 - Configuration of Sales&CM file

Validation (Monthly Fcst)		Intercompany sales													
		Trade sales													
		CM													
				SALES VOLUME | CM % | CM $											
Site	Product Solution	Scenario	Sales/ CM	J	F	M	A	M	J	J	A	S	O	N	D
ITALY - EMEA	Graphic tags	ACTUAL / FORECAST | PREVIOUS YEAR | AOP	GROSS TRAD INTERC EOMPANY												
	EAS														
	Packaging														
	Woven Labels														
	Transfers / Interior														
	External Embellishment														
	Component Weave														
	Embroidery & Patches														
	Price Tickets & Variable Data														
	Printed Fabric Label														
	In-plant Printing Solutions														
	RFID														
	Inventory & Routing Solutions														
	Fastener Solutions														
	Other														
	Total														

The OPEX

Moving on with the analysis, the next detail file of the Flash&Forecast is the "Opex", which means Operating Expenses. This file entails additional details of the main cost items resulting from the financial statement submitted in Hyperion Financial Management divided by expense category; each account is internally mapped on the basis of its nature from the profits and losses account voices to the expense category, and it is then reported on the file. The expense category is internally established, in fact, every business unit makes its considerations about account items descriptions and it matches them with the most suitable category. In table 3.7 an example of the Opex file is presented; as the files above, data are displayed in actual/forecast, AOP and previous year. The main cost items deriving from the income statement are Direct Material, Direct Labor, Direct Overhead, IME, FDGE and Local SGA. As stated above, to each one of them, an expense category has been assigned, as well as the expense type of reference, which may be Employee, Non-employee and Other. An additional information provided in this file is given by the Headcounts, or rather the actual number of employees working for each income statement voice. Moreover, similarly to the Sales&CM file, the Opex file consists of a cross-check with the Flash&Forecast file, as a consequence, there should not be differences between cost items.

Table 3.7 - Example of Opex file

ITALY - EMEA			ACTUAL/FORECAST – AOP – PY											
EXPENSE TYPE	**EXPENSE CATEGORY**	**P&L**	**J**	**F**	**M**	**A**	**M**	**J**	**J**	**A**	**S**	**O**	**N**	**D**
• **Employee** • **Non-employee** • **Other**	Salary / Wages / Benefits Overtime pay Bonus Outsourced Travel Freight Expense Rent & Facilities …	• Direct Material • Direct Labor • Direct Overhead • IME • FGDE • Local SGA												
	Headcount per each P&L													
Total														

<u>The Working Capital and Free Cash Flow Variance</u>

Another Flash&Forecast's detail file is the "Working Capital and Free Cash Flow Variance", that is the analysis of the variances of current month values (actual data) with respect to values of the same month predicted in forecast, in AOP, or resulting from previous year. All this information is contained in one single file, from which financial controllers and general managers collect numbers relative to each business unit across the various regions. Hence, the role of the financial analyst is to fill the parts of the file regarding his business unit and add explanations

wherever it verifies a significant variance between data predicted on the budget (alongside those predicted on the Flash) and data resulting from the ordinary course of the business. Starting from working capital, the main account item variances that need to be reported are those regarding:

- *Accounts Receivable* (AR)
- *Accounts Payable* (AP)
- *Inventory*

The aforementioned items follow the same path, where different values of the same reference month are compared, and their differences are analyzed and justified. Variances are distinguished between "Volume" and "Non-Volume" on the basis of their nature: concerning variances with respect to AOP (Variance VS Plan in table 3.8), volume variances are those differences which are strictly related to sales, while non-volume variances are those which are mainly related to other events or other reasons; concerning variances with respect to the forecast (Variance VS Q Fcst in the table), non-volume variances are those given by the difference between the estimated volume variance and the real variance (influenced also by other external factors), while volume variances are given by the forecasted value and the actual value. As per the latter variance, an additional explanation for the accounts receivable item is needed: due to the fact that for this particular item the reference is mainly on trade receivables, volume variances are most of the times given by the difference between the quantity forecasted in the Flash and the prevision of trade receivables amount on the basis of the last 3 months of "adjusted trade sales"[149]. To make an example, if an amount of 12.000$ AR (credit balance), collectable for 30% in April, 40% in May and 30% in June, has been predicted on the Flash, but the actual amount is 11.000$, with the same percentage of credit collection, the difference between 12.000 and 11.000 will represent a "volume variance" and it will be reflected also on the predicted percentages in April, May and June; any other

[149] Adjusted Trade Sales is a balance sheet item which is given by Net Sales + Adjusted VAT.

additional variance between 11.000$ and the actual results will instead represent a "non-volume variance", because dependent on other factors, not directly related to sales.

Moving on with free cash flow, the main account item variances that need to be presented to upper level management are:

- *Payroll;*
- *Other accruals*, which contains accruals for tax liabilities, VAT, trade rebates, other liabilities, statutory audit fees, customer refund liability, contract liability, insurance liability, discounts and other adjustments, and freight out;
- *Prepaid*, which include insurance prepaid and other accounts such as advances to suppliers;
- *Other Receivables*, which include tax receivables and other receivables, such as deposit rents and utilities.

Among these categories, the ones which usually are the heaviest are "other accruals" and "prepaid", so they need a more accurate explanation than the others. In the table below, an example of the file is given; this table represents the basis to use for each account item variance explained above.

Table 3.8 - Example of Working Capital and Free Cash Flow Variance file

AR / AP / INVENTORY – PAYROLL / OTHER ACCRUALS / PREPAID / OTHER RECEIVABLES											
PERIOD	MAY						VAR. VS Plan		VAR. VS Q Fcst		Comm ents
SITE	Actual	Q Fcst	AOP	PY	VS QFcst	VS AOP	Non -vol.	Vol.	Non -vol.	Vol.	
…											
ASIA TOTAL											
Turkey											
Italy											
Iberia											
Germany											
United Kingdom											
EMEA TOTAL											
…											
AMERICA TOTAL											
APPAREL GLOBAL											

The Capex Tracker

Another relevant file of detail for the Flash&Forecast is given by the "Capex Tracker", where by capex is meant capital expenses. The Capex Tracker shows the detailed expense by asset on a monthly basis where by monthly expense is meant the actual money transfer for the purchase of the capital asset. In substance, it is a list of all the assets planned in the budget, and those needed in the course of the period, which need an AFE to be purchased. An AFE is an authorization for expenditure which is very common in multinational corporations to keep track and to monitor the expenses of their subsidiaries. The submission of the AFE in fact, is

connected to a list of authorized persons which are responsible for the "view" and the "approval" of the AFE itself: the viewers are those individuals accountable for being informed about the AFE in question, while the approvers[150] are those which, on the basis of their job position, detain the power and are accountable for deciding if an expense has to be incurred or not. The authorization is obtained through the compilation of an online format in which the business unit must insert all the information about the assets it needs to buy. Information such as the name and the description of the asset, the amount, the business site where it will be located once acquired, the initial expense, the relative depreciation it derives from the usage and then the comparison with the relative "hard benefits" deriving from the purchase (in terms of higher sales, savings, lost sales reduction), the impact on the business of purchasing or not the asset, and so on, are displayed. Also, by comparing benefits and expenses, it is possible to obtain the investment rate of return (IRR), or rather the index which tells the holding how much (in terms of percentage) it will be possible to get back from the incurred asset expense, as well as an estimation of the payback period.

In table 3.9 a configuration of the Capex Tracker file is depicted; the table shows the site to which the asset is addressed, the name and the number of the AFE, the type of business for which they have been purchased (the various types of business are shown in the table), the product category (product categories are listed in the table below), the amount of the asset, the status of the project (with regards to the obtainment of the AFE too), the presence or not of savings project connected to the asset in reference, and finally, the month in which the expenditure took place (actual data) or will take place (forecast data). One last consideration, the Capex Tracker is a file which, as the previous ones, considers and displays data also in annual operating planning data and previous year data.

[150] The expense power hierarchy is established on the basis of a matrix called "Approval Authorization Limit", specifically, the accountability for approving an expenditure starts from the lowest level authorization and it goes up to the top-level management.

Table 3.9 - The Capex Tracker Configuration file

ACTUAL/FORECAST				ANNUAL OPERATING PLANNING						PREVIOUS YEAR	
Site	AFE name	AFE nr.	Platform type	Project category	Priority	Impact on sales	Savings	Payback	Total AFE	Project status	J F M A M J J A S O N D
Italy			Woven	Global Manuf. Automation						PO raised	
			Digital	Capacity/ Growth						Machine received	
			Flexo	Productivity						Inspected	
			Offset	Innovation						Project completed	
			Component weave	Project fin						Pending on payment	
			Transfers	Footprint						Project closed	
			Thermal	EH&S/ Compliance						Yet to initiate AFE	
			PFL	Maintenance						Pending on AFE approval	
			RFID	IT hardware or software						Cancelled	
			Non-platform	Non ops							
			Printing & Converting								

The Savings Tracker

The next file is the "Savings Tracker", which represents a list of projects in which a plan of savings is developed and then tracked to have an accurate check of the actual project trend. An example of the file may be found in table 4.10, where it is possible to see how the project is monitored, from its beginnings to its end. More specifically, in the table are shown:

- Starting year;
- Project description;

- If it is a “Local” or a “Global” project[151];
- Project type, which indicates if the project involves decisions regarding the procurement, or rather an increase in productivity, or other;
- Project category, which may concern categories such as direct labor, prices negotiation, or other;
- Key commodity code, which is useful to identify the commodity to which the project may be associated (if applicable);
- The total amount of the saving;
- Start date and end date;
- Profits and Losses line impact, that is the impact on the US GAAP income statement item, such as Labor, IME, Material, and so on.

The savings tracker basically consists in the provision of annual projects, mainly determined by responsibility center directors or controllers. They generally involve operations and manufacturing directors/supervisors because of the fact that the most spread typology of savings regards material purchases and the reduction of machines and personnel usage in the production process. The list of the projected savings has to be elaborated and presented to the management during the budget planning and programming phase, in order to be immediately reflected on the profits and losses statement.

[151] By “local” is meant a project which only involves the business unit or the country in reference (for instance, a software change or a negotiation of terms). By “global” is meant a project which is imposed by the holding company on all its business units or on a particular region.

Table 3.10 - Example of the “Saving Tracker” file

ACTUAL / FORECAST				AOP		PREVIOUS YEAR			
Starting year	Proj. Description	Local / Global	Proj. Type	Proj. Category	Key commodity code	Tot	Start date	End date	P&L Line impact

<u>The MBR and QBR</u>

Last but not least, the MBR / QBR file. This is a set of synthetic reports which concisely show and explain monthly and quarterly results to region directors, which will further on use the main information to present the trend of the various business units to the vice president of the multinational corporation. The report contains written explanations about the differences – so, it does not include numbers apart from the single increases or decreases to show – divided between:

- Profits & Losses Key Highlights;
- Working Capital Key Highlights;
- Market Overview;
- Challenges and Risks (Sales & EBIT impact);
- Opportunities and Key Initiatives (Sales & EBIT impact).

As per the P&L Key Highlights, the comparison is made on “Quarter”, “Month-To-Date” and “Quarter-To-Date”, with respect to forecast data and previous year data.

The main items that are exposed are the “Outside Sales”, the “Intercompany Sales”, the “Manufacturing Operating Expenses” and the “Sales General Administration”; for each one of them financial analysts are asked to provide a short, but effective, explanation. In addition, it is important to underline that in case the MBR/QBR file is filled at quarter not closed (in May of Q2, for instance), quarterly data will be “actual data” for April and May, but they will be “forecast data” for June, and quarter-to-date data will be showed until May, not until June.

To what it concerns Working Capital Key Highlights, the comparison is made on “Quarter” and “Month-to-date” only, with respect to forecast data and previous year data. The main items exposed are the “Trade Receivables”, the “Trade Payables” and the “Inventory Net”; also, in this case, for each one of them a short description is requested.

Finally, with regards to Market Overview, Challenges and Risks, Opportunities and Key Initiatives, this information are “Quarter-to-date” and they are provided by business unit Directors, particularly Sales and Finance BU Directors, which are responsible for making the appropriate evaluations and report them in this file.

Table 3.11 - Example of MBR/QBR file

ITALY	MONTH X – QBR/MBR
P&L Key Highlights	MTD – vs Forecast MTD – vs Previous Year
P&L Key Highlights	QTD – vs Forecast QTD – vs Previous Year
P&L Key Highlights	Q – vs Forecast Q – vs Previous Year
WC Key Highlights	MTD – vs Forecast MTD – vs Previous Year
WC Key Highlights	Q – vs Forecast Q – vs Previous Year
Market Overview	
Challenges and Risks	
Opportunities and Key Initiatives	

2) Balance Sheet Review

The balance sheet review is a monitoring tool to assist in ensuring that business units perform account reconciliations timely, accurately, and in accordance with the Financial Handbook policy[152]. The main objectives of the balance sheet review are to promote and support a forceful internal control environment, and to improve the quality and accuracy of financial reporting. Internal control consists indeed in a process where an entity, inside the company, has the scope to provide reasonable

[152] The financial handbook policy is an internal file which illustrates the main procedures and techniques that the financial department need to adopt in order to be in line with the conducts imposed by the holding company. For privacy reasons these policies will not be exposed, they will be only re-elaborated in text and changed in numbers.

assurance in terms of effectiveness and efficiency of the operations, reliability of financial reporting, and compliance with applicable laws and regulations. The review may be conducted "on-site" or "by remote", after the documentation needed has been forwarded, and it is assigned to an independent person, where by independent is meant a person from another corporate group or business group/division, but also a person from the same business group/division[153].

The balance sheet review procedure starts at upper levels of management, where finance directors proceed to examine and assess the risk profile of the various business units; in fact, the approach to the internal control will be different on the basis of each entity's risk profile[154]. The second step is at lower levels of management, in particular, the finance department, which proceeds with the balance sheet reconciliation. This latter, represents one of the key elements to "closing the books" at the end of an accounting period and it consists in the comparison between the balance sheet general ledger accounts and the details that built up those balances; the reconciliation makes sure that any differences between the two amounts are effectively explained and reasonable. The main purpose of the balance sheet reconciliation is to prevent and detect errors or internal frauds thanks to its ability to detect missing, duplicated or untimely transactions, to monitor the organization's activities, and to track the various regulatory compliance items (such as required reserves and allowances). The reconciliation is conducted through the usage of standard account reconciliation templates where financial analysts indicate the various accounts composition, in order to verify that every choice has been taken and every account registered according to either the US Gaap or the internal policy imposed by the holding company. Each business unit must complete a

[153] For instance: a finance manager from another business unit or global/business unit financial controllers.

[154] Each entity is connected to a risk profile: "limited transaction entities" are subjected to a balance sheet review once every 2 years, "limited risk entities" and "full scope units" are instead subjected to an annual review.

reconciliation of all key balance sheet accounts on a monthly basis, all the others must be reconciled on a routine basis, specifically, at the end of the quarter – unless a risk assessment[155] has been conducted to determine that another cadence is acceptable. The "key accounts" for the monthly reconciliation are:

- Cash and Hedging;
- Accounts Receivables and Payables (especially trade receivables and payables);
- Inventory;
- Goods Received Not Invoiced;
- Accrued Liabilities and Rebates.

As stated above, all balance sheet accounts must be fully reconciled for each quarter close and documented on the aforementioned standardized templates, unless they have been approved by the Corporate Controller. The templates, are built-in functions of an accounting software package (Hyperion Financial Performance Management) aimed at assisting users with performing the reconciliations, in fact, they are designed to ensure that only the appropriate information will be captured, so that the account will be fully reconciled; in this case, the account reconciliation templates imposed by the corporation are "Balances supported by Sub-ledger" (accounts receivables, payables, inventory), "Bad debt reserves" (expired credits), "Inventory reserves", "Prepayments/accruals" and "All other accounts". These templates are followed by supporting documentation[156] which is needed to justify the corresponding balance sheet general ledger (and subledger) accounts. Another

[155] Balance sheet accounts are differentiated into 3 risk categories: high risk (cash, bank balances and trade receivables/payables) and medium risk accounts (such as rebates, goods received not invoiced, and others) are subjected to a monthly reconciliation, while low risk accounts (such as equity, fixed assets, perpetual inventory and other accruals) are subjected to a quarterly reconciliation.

[156] Supporting documentation is composed by official documents, or rather those documents which have been created from third parties (bank statements, payroll reports, and other documents considered to be reliable), and internal documents which financial analysts attach to the accounts in order to explain the source of his accounting decision.

relevant aspect to consider in the balance sheet reconciliation is given by the "materiality", that is a threshold to identify the balance sheet accounts which must be subjected to reconciliation. Indeed, according to the internal policy, the accounts (key accounts and other accounts) that need to be mandatory reconciliated have to be chosen between those who have the lowest amount among: 1% of the revenues of the last 12 months, 1% of the assets of the month and 300.000,00$ (€ converted on the basis of the fixed exchange rate of the month established at corporate level for the whole group), which represents the maximum amount permitted by the policy. In any case, those accounts who have an amount lower than 15.000,00$, that is the minimum materiality level, will not be reconciliated because the risk and exposure is considered immaterial.

At the end of the balance sheet review, the result of the internal control must be reported to the corporate; every aspect of the review which is not considered to be in line with the policy or with the US Gaap, and which is consequently pointed out by the controller, is called "findings", and it may be subdivided among two categories:

- Material findings, or rather all those findings considered by the corporate as representative of a significant financial and/or control risk to the business unit. This finding requires the immediate attention of management and should be addressed and closed as a matter of urgency (within the 2 months subsequent the discovery);
- Other findings, or rather all those findings, which are not material findings, raised by the reviewer which require the attention of the balance sheet owner (within the 3 months subsequent the discovery).

3) Quarterly attestations

Among the various reporting activities, there is one in particular whose aim is to attest that the business unit is acting following the policy established and imposed by the corporate (in the specific case of the financial department, the concern is on the financial policies, particularly, on the respect of the Financial Handbook). This activity consists in the compilation of quarterly templates and attestations, composed by:

- Checklist
- Representation letter
- Sales discussion

The first document is, as its appellative suggests, a check of the financial activity regarding the balance sheet; its aim is to have a written confirmation, signed by financial analysts, in which it is stated that the department had correctly acted. The template is composed of a first part where general questions are undergone, then it goes through all the balance sheet items, where specific questions about how these account items have been built are asked. In addition to that, at the end of the template, there is a part dedicated to all the policy exceptions; each business unit, in fact, has the possibility to ask for exceptions to the corporate, however, these must only be due to domestic laws of the country of origin or internal regulations, authorized by the corporate. In table 3.12 it is possible to see an example of the checklist, together with some question samples.

Table 3.12 - Quarterly financial checklist

AREA	RESPONSE (YES/NO)
A. GENERAL (Example: Are you prepared to explain any significant variances in Balance Sheet and P&L accounts?)	
B. CASH (Example: Are all bank accounts reconciled for each legal entity?)	
C. ACCOUNTS RECEIVABLES (Example: Has an account receivables aging schedule been prepared?)	
D. INVENTORY (Example: Have all reconciling items been recorded to the general ledger?)	
E. OTHER CURRENT ASSETS (Example: Are the other receivables expected to be collected in the next 12 months?)	
F. PROPERTY, PLANT & EQUIPMENT (Example: Does the fixed assets ledger agree to the general ledger?)	
G. OTHER ASSETS (Example: Has a detailed list of items included in other assets been created and reviewed?)	
H. DEFERRED CHARGES (Example: Does the amortization expense for deferred charges appear reasonable?)	
I. ACCOUNTS PAYABLE (Example: Have reconciliations of the subledgers to the general ledger been performed for all entities?)	
J. ACCRUED EXPENSES (Example: Are all accrued liabilities recorded in the appropriate accounts?)	
K. DEBT (Example: Is the business in compliance with all applicable debt covenants?)	
L. EQUITY (Example: Have all dividends declared been properly recorded in Dividend Income and Equity?)	
M. INTERCOMPANY BALANCES (Example: Have intercompany balances been reconciled with appropriate related parties?)	
N. DEFERRED TAXES (Example: Have all income tax exposure or valuation items been communicated to Corporate Tax?)	
O. DERIVATIVES / HEDGES (Example: Is the hedge contract being recorded in accordance with US Gaap and reported in the appropriate accounts?)	
P. FAIR VALUE MEASUREMENTS (Example: Has the fair value measurement been applied to the corresponding assets and liabilities in line with the US Gaap and the Corporate Financial Reporting?)	
Q. FUNCTIONAL CURRENCY (Example: Has the functional currency been assessed in accordance with Financial Handbook?)	
R. LEASES (Example: Are all leases properly classified and accounted for based on the Financial Handbook?)	
Detailed explanation of "NO" answers	

The second document, the representation letter, is a written attestation (usually it is a pre-filled document) sent from the corporate to the business units, where they have to confirm that the financial statement of the quarter has been drawn up according to corporation's policy and in line with the US Gaap. The format of the letter is very similar from year to year, it is subjected to changes only if the business units have experienced some unusual operations as well as in case of modifications in domestic/international laws, which will need a further explanation.

The third document is the quarterly sales discussion, that is a tool aimed at attesting that the sales department and the finance department communicate with each other for what it concerns the topic of revenue recognition. In other words, sales managers attest to always update financial managers in terms of new contracts or changes in contracts with clients (which might have an impact on the financial statement), in order to ensure the completeness and accuracy of revenue recognition in accordance with the company's financial handbook policies. The sales discussion is a sort of checklist, but it also includes the written comments of the two departments managers. In order to have a better view of this template, an example is given in table 3.13.

Table 3.13 - Quarterly sales discussion

			SALES/MARKETING	FINANCE
Contract terms	Remarks	Y/N	If YES, describe	If YES, comment
Nonstandard or extended payment terms	Refers to exceptional terms granted to customers	Y	Some customers are exceptionally granted a different payment term (e.g. 90D instead of 60).	This exception is only for old customers.
Other terms				

CONCLUSIONS

Multinational companies have outlined the modern business world environment thanks to their ability to expand a company's hedges in terms of market share, but also to transfer and replicate organizational knowledge and practices from one country to another. This paper envisaged a comprehensive view of the internationalization process, from the history of multinational corporations, to the phases of the strategic planning process, their implementation, the following control mechanisms for the management of such complex organizational structures, until reaching the application of the theory to the case study.

Corporations have been subjected to a real evolution through time, and they consequently adapted to the new environment by modifying and innovating their organizational structures moving from typical designs such as functional and divisional structures to matrix structures, networks, and yet learning organizations – or rather those companies who actively seek to acquire knowledge and change behavior as a result of the latter. In parallel, multinational corporations have learned to build a group common language in light of the fact that they are very often involved in crossing language boundaries, different management accounting principles and different environmental conditions; by using a "parent functional language" multinational enterprises have indeed facilitated global coordination and intra-network communication, reduced time-consuming translations, and consequently saving costs.

The reasons behind the choice of a company to go international may vary among the possibility to achieve world-scale volumes, the possibility to gain market power in the foreign market, but also to encounter a more profitable resource access and consequently save costs. The most appropriate decision whether to internationalize or not, however, is taken through the strategic planning process, by which firm's

managers evaluate the future perspectives of the company in question and decide on the strategies that will ensure the achievement of long-term objectives.

The paper showed, however, that in order to make the most of its potential, the internationalization process must be accompanied by a managerial development plan, therefore, multinational corporations are strongly recommended to invest in the group's managerial mechanisms, and particularly in planning, control and measure of the performance systems.

Starting from the strategic planning, it is in this occasion that the main strategic priorities and business goals to pursue during the operational activity are identified. Here, the main focus was given to the evaluation of the trade-off between global integration and national responsiveness; as previously showed, the principal core of this conflict is the approach that the company will implement to compete in the market, and which provides the localization of the activities of the company in geographical terms (configuration: to locate the company's activities in one country or all over the world) on the one hand, and the way in which the activities are located and connected (coordination: to centralize the management of geographically dispersed activities or decentralize and locally manage the activities) on the other hand. In this phase of the planning process indeed, the management's first choice is whether to pursue a global or a multidomestic strategy – notwithstanding the additional strategies deriving from these two, the complex global strategy and the more recent transnational strategy. On the basis of which approach to undertake, at last, the management will decide on what kind of entry strategy would better fit both the company and the relative foreign market.

The analysis moved then to the management control, that is a management function whose aim is to achieve the defined goals within an established timetable; as observed, management control consists mainly in the set of the standards to achieve, the measuring of the actual performances and the relative corrective actions to implement. More specifically, control in multinational corporation is

usually differentiated between process control, output control, and social control. By efficiently adopting the three of them, multinational companies would meet the coordination requirements that are typically challenging to achieve in an internationalized firm. The reason behind this is given by the characteristics of each control mechanism:

- process control generally allows the management to strategically allocate the company's most critical resources through the adoption of a management information system which ensures real-time monitoring and coordination worldwide;
- output control allows the management to connect plans, programs, policies and decisions for the analysis and balancing of global competitive advantages with local peculiarities, this is achievable through the use of traditional mechanisms such as planning systems, investment analysis, budgeting, reporting and performance measure;
- social control focuses instead on the set of guidelines for behaviors based on cultural variables, sharing of beliefs, values and role models; this form of control must not be underestimated due to the importance for multinational companies to create a multicultural environment, based on worldwide coordination and communication.

The paper shifted then to the phases of the management control process where, in the end, a particular attention was given to the team of financial planning and analysis, a new task born and then become necessary in multinational corporations. Indeed, the main activity of the so-called FP&A is to provide the corporate with financial reports which purpose is to guarantee internal rules compliance and accountancy integrity in the eyes of the main stakeholders, by using tools such as the turnover, the contribution margin and cost reduction.

The role of the financial planning and analysis team has been subsequently reported in the last chapter of this paper, the case study. The chapter started with a

brief introduction of the company and its evolution from a familiar business onto a business unit of a multinational corporation, and then shifted to the analysis of the main tasks of the finance department of the company – that are immediately attributable to the scenarios and tasks described in the previous chapters. In fact, the organizational structure of the company was depicted in the first place, this resulted in a corporate organigram that is a mixture of divisional and functional structure. After that, a reference was made with regards to the management information system, the ERP system Oracle11, or rather the integrated set of software modules that manages the company's accounting, distribution, manufacturing, and other functions – essential for a multinational company.

Later on, the case study geared to the cash pooling activity, the cash management strategy whose objective is to bring together credit and debit balances of the same corporation, creating a "pool" of bank accounts. The main reason why cash pooling is widely spread among multinational companies has been outlined and it lies in the fact that it allows to effectively manage global liquidity, simplify bank account structures/procedures, and reduce overall bank transaction costs. In particular, the paper focused on the cash pooling technique adopted by the company under analysis: the "zero balance" pooling, that is the practice through which at the end of the working day all the final positions of business units' bank accounts are brought to zero and flow into one single bank account. For the European region of the corporation, the bank account positions are managed by the treasury company – located in The Netherlands – especially created for managing the liquidity of the group and mitigating operational, financial and reputational risk. The cash pooling accounts have been identified in the case study, and it resulted that they are divided between two main positions:

- two bank accounts, one in Euros and one in US Dollars, which go to zero at the end of every working day;

- a deposit that is recapitulative of the overall situation of liquidity, both in Euros and US Dollars, that never goes to zero (cash pooling account directly with the treasury company).

The underlined aspect of the cash pooling practice is that monthly bank accounts of each business unit must be in line with the ones of the Treasury; the check is made by comparing the own balance of each country with respect to the intercompany loan statement.

Furthermore, due to its nature of multinational corporation, the company carries out transactions in different currencies, this leads to the possibility to encounter gains/losses on foreign exchange rates. For this reason, the corporate has implemented a tool to monitor and limit the potential impact on earnings resulting from foreign exchange rate fluctuations (which has to be adopted in every business unit). The tool is called "hedge" and it allows to get a foreign rate impact that is contrary to the one that will be realized the subsequent month, in such a way that the impact will basically be netted. Its value is established by the corporate on the basis of the amount forecasted and communicated by the business unit in a specific template showed in the chapter, "the balance sheet foreign exchange exposure", where the units are asked to fill in the amounts relative to risky accounts – such as trade payables/receivables and the debt vs the treasury – with the estimation of the foreign exchange exposure of the following month. The compilation of the template ensures that the value of the gains and losses on foreign exchange of the Hedge is able to compensate the value of gains and losses deriving from trade receivables/payables, plus, the debt towards the treasury.

The final topic of the case study concerned the financial reporting activity, particularly focused on forecasting tools, balance sheet review and quarterly attestations. This part comprehended a series of reports and tables that build up the activity of financial accounting, which aim is to provide an accurate outlook of the company's financial metrics to key stakeholders, but also to provide an analysis of

the company's performance against the financial plans and strategies. The reports and tables were set on the basis of the original ones used by the company, and their compilation is subjected to a determined schedule – which has been displayed in the chapter. The forecasting tools are mainly imposed by the corporate to its business units all over the world, those are indeed divided by geographical area and country, and they serve to control the activity of business units and their trend in terms of sales, contribution margin, working capital, operating expenses, capital expenses, saving plans, and all those other aspects that are relevant for the corporate to monitor. The balance sheet review serves also as a monitoring tool, but in making sure that the business unit performs account reconciliations timely, accurately, and in accordance with the internal "financial handbook policy"; hence, it is a means to support internal control and improve the quality of financial reporting. Among the others, the account items that are most of the times subjected to monthly reconciliation in the company under analysis are cash, account receivables and payables, inventory, and goods received not invoiced. Finally, quarterly attestations are additional reports imposed by the headquarter which aim is to attest that the business unit is acting in compliance with the policy established and imposed by the corporate. The templates included in this part generally consist in the attestation that preestablished procedures have been followed.

In conclusion, the environment of a multinational corporation, albeit offering major opportunities in terms of market share and global scale volume achievement, envisages particular business dynamics characterized by strict control procedures and hunt for the best performance obtainable. Notwithstanding, the most performing corporations are those who are able to create the right balance between planning and control mechanisms, without neglecting the human capital who is involved in the process every day.

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FIGURES

TABLES