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THE EFFECT OF TQM FACTORS ON FINANCIAL AND STRATEGIC PERFORMANCE: AN EMPIRICAL TEST USING PUBLIC MANUFACTURING FIRMS

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ABSTRACT

Although interest in implementing the total quality management (TQM) philosophy as part of competitive and operational strategies has been around for approximately 25 years, there has been little empirical evidence to suggest that it has a positive affect on an organization's financial and strategic performance. Part of the problem is that a testable framework of TQM constructs has been slow to emerge. This research provides a test instrument and an empirically reliable framework to evaluate an organization's TQM implementation. This study of 257 manufacturing firms provides definitive evidence that TQM implementation is a significant predictor of customer satisfaction and a weak but significant predictor that TQM is associated with the improvement of several financial variables. Lastly, the findings suggest that the impact of the TQM variables on performance is highly correlated with duration but is not significantly correlated with either organizational size or industrial specialty. This suggests the robustness of the TQM philosophy as part of any competitive or operational strategy. Lastly, the findings clearly suggest that organizations using the TQM constructs will continue to improve over time.

INTRODUCTION

Total Quality Management (TQM) provides a paradigm shift in management philosophy for improving organization effectiveness (Byrne, 1992; Gagne, 1983; Lowe and Masseo, 1986; Tenner and DeToro, 1992; Waldman, 1994). TQM managers focus efforts of all members to continuously improve all organizational processes and increase value to customers, while relying upon a clear vision of the organization's purpose. This depends on the use of improvement tools (e.g., SPC, benchmarking, process/product improvement teams) and the removal of barriers both with the organization and between the organization and its various stakeholders. TQM has been embraced by thousands of organizations (Lawler and Mohrmon, 1992) as an important management component of operational strategies. However, despite its theoretical promise and enthusiastic response, anecdotal evidence suggests that attempts to implement it and/or achieve financial benefits are often unsuccessful (Erickson, 1992; Fuchsberg, 1992; Kendrick, 1993).

Anecdotal studies have most commonly attributed the failures of TQM implementation and financial improvement to deficiencies of: (1) shared vision, (2) application planning, (3) organizational commitment, (4) training, (5) reward systems, (6) empowerment, or (7) cross-functional integration (Brown et al., 1994; Danjin and Cutcher-Gershenfeld, 1992; Doyle, 1992; Emery and Summers, 1992; Gilbert, 1993). Unfortunately, few empirical studies have been initiated to examine relationships between TQM components and the success/failures of implementation. Part of the problem is that an agreed upon framework of TQM constructs has been slow to emerge. The purpose of this study is first, to develop an aggregated TQM framework from previous studies and second, to use this framework to test the relationship between various constructs/variables (including time since implementation) and financial/strategic performance.

TOTAL QUALITY MANAGEMENT RESEARCH

During the 1990's there were several key studies that attempted to demonstrate a relationship between TQM and organizational performance. Although these studies advanced our qualitative understanding of TQM, they were often flawed by inadequate sample size, failure to fully define constructs, lack of control variables, and for confusing quality management practices with measures of quality performance. In addition to the inadequate sample size, there were no control firms or other control variables present to provide any measure of statistical rigor. Also, during the 1990's there were several key theoretical and empirical studies that proposed similar TQM constructs (Saraph, Benson & Shroeder, 1989; Flynn, Schroeder & Sakakibara, 1994; Anderson, Rungtusanatham & Schroeder, 1994; Flynn, Schroeder & Sakakibara, 1995; Ahire, et al., 1996; Black & Porter, 1996). The following framework of TQM constructs are presented as an amalgamation of these studies along with those practices identified and measured by the Malcolm Baldrige Award criteria (Award, 2005).

Top Management Commitment

Top management commitment is a necessary and essential element for achieving successful implementation of a total quality program (Deming, 1982; Garvin, 1987; Leonard & Sasser, 1982; Saraph, Benson & Schroeder, 1989; Ahire, et al., 1996). Top management is responsible for setting quality goals and strategies and providing resources to enable implementation of a total quality program.

Customer focus

Recent empirical studies agree that TQM cannot exist without a strong customer focus. There must be systems and processes devoted to learning more about customer requirements and improving customer satisfaction (GAO, 1991; Dean & Bowen, 1994; Anderson, et al., 1995; Black & Porter, 1996; Ahire, et al., 1996; Madu, et al., 1995;). A main component of Deming's Chain Reaction (1982) was that improving quality through the firm resulted in better quality products at a lower price that would so satisfy customers that market share would be increased, the company would stay in business and more and more jobs would be provided.

Supplier relationships

Deming (1982) was the first to advocate limiting the number of suppliers and establishing long-term relationships based on quality. By selecting and monitoring suppliers based on non-price selection criteria, research has found an improvement in financial and operational performance (Ittner, Larcker, Nagar & Rajan, 1997). Assuring a reliable source of high-quality parts reduces costs related to inspection of in-coming materials and down time due to defective materials. Effective partnering between manufacturers and suppliers allows the manufacturer to reduce ordering and inventory costs, which are important components of total logistics costs.

Employee training

Total quality management involves combining concepts and practices drawn from various disciplines (e.g. management, marketing, psychology, engineering, etc.) and is so comprehensive that it requires that all employees receive formal training in total quality concepts and tools to be effective (Ishikawa, 1976; Crosby, 1979; Juran, 1980; Deming, 1982; Ahire, et al., 1996). In addition to training in quality concepts, overall performance and employee satisfaction is enhanced when employees also receive technical and vocational work-skill training which develops additional skills and creates value for both employer and employee (Leonard & Sasser, 1982).

Employee empowerment

One definition of empowerment is "giving workers the training and authority they need to manage their own jobs" (Raiborn, Barfield & Kinney, 1996, p. 49). Ahire, et al. (1996) state that "employee empowerment is essential to improve in-process quality control" (p. 31). Empowering employees encourages them to take responsibility for their own work and to be more proactive in finding solutions for problems as they arise. Costs of quality can be reduced by detecting and correcting errors during in-process production rather than after production. Empowered employees are encouraged to prevent and/or detect errors early in the production process rather than relying on final inspections. Therefore, empowerment can lead to significant savings by reducing defects and the need for rework.

Continuous improvement tools

Specific tools are available to provide objective ways of measuring and controlling variation in the production process. These are primarily statistical process control (SPC) methods first advocated by Shewhart (1931) and Deming (1982). Since then many researchers have concurred that SPC is an effective way to improve quality on a continuous basis, particularly for firms just adopting quality initiatives (Garvin, 1986; Flynn, Schroeder & Sakakibara, 1995; Ahire, et al., 1996; Grandzol & Gershon, 1997). Benchmarking should also be included as a continuous improvement tool since it seeks out best practices and products from within the firm or among competitors. The objective data which continuous improvement tools provide should be analyzed and used to keep manufacturing processes under control and determine how the firm can make improvements to its products or processes, thereby always striving for continuous improvement.

Design and process improvement

The construct of design and process improvement includes tools and practices which manage and control design and production systems to maintain and improve quality throughout the organization. Design and process improvement includes design and control of setup procedures, maintenance and repair (Adam, Herschauer, and Ruch, 1981), zero-defect planning (Crosby, 1979), process improvement through problem analysis (Ishikawa, 1976) and design process control (Grandzol & Gershon, 1997). The Ernst & Young Best Practices Report (1993) found that all process improvement practices proved beneficial to firms at all levels of performance.

Internal cooperation and open organization

A total quality culture emphasizes cooperative behavior between organizational members (Bushe, 1988; Bossink, Gieskes & Pas, 1993), and encourages sharing information and assisting coworkers to accomplish tasks and solve problems (Waldman, 1994). Leonard & Sasser (1982) observed that the most effective quality programs exhibited open and fluid participation that "cut across traditional organizational boundaries" (p. 168). The following topic areas can be used to measure the extent of internal cooperation and open organization:

Hypotheses

After developing the aggregated TQM framework, the primary purpose of this study is to test the framework and implementation time against several key financial and strategic variables. A secondary purpose of the study was to examine the relationships between the number of years of TQM implementation and several financial and strategic variables. It has been previously suggested that the financial and strategic variables should be positively correlated with the length of time that a TQM philosophy has been in place. As such, the following hypotheses

H1: The aggregate TQM variable will be positively correlated with a change in net income.
H2: The aggregate TQM variable will be negatively correlated with a change in operating expenses as a percentage of sales
H3: The aggregate TQM variable will be positively correlated with a change in gross profit margin
H4: The aggregate TQM variable will be positively correlated with a change in sales
H5: The aggregate TQM variable will be positively correlated with a change in customer satisfaction.
H6: The number of years of TQM implementation will be positively correlated with change in net income.
H7: The number of years of TQM implementation will be positively correlated with a change in operating expenses.
H8: The number of years of TQM implementation will be positively correlated with a change in gross profit margin.
H9: The number of years of TQM implementation will be positively correlated with a change in sales
H10: The number of years of TQM implementation will be positively correlated with a change in Customer Satisfaction
H11: The number of years of TQM implementation will be positively correlated with a change in the aggregate TQM score

METHOD

This study focuses on U.S. manufacturing firms. In order to employ statistically rigorous research methods, a large-scale mail study was used to obtain a sufficient amount of data. The target population chosen from manufacturing firms listed on the Compustat database (SIC 2000 – 3999 or NAICS 30000-33999). Targeted respondents were high-ranking executives, holding titles such as Vice President of Manufacturing, Vice President of Operations, President, etc. Eventually, the number of number of manufacturing firms was reduced from 1,962 to 257 because the firm was either non-responsive or wasn't in the Compustat database for five years.

RESULTS AND DISCUSSION

The primary purpose of this study was to develop and test an unweighted framework of aggregated TQM constructs against several key financial and strategic variables. The hope was that the aggregated TQM variable would be positively correlated with a change in net income. If that was the case, the task was to determine the possible cause of such a change, i.e. a change in sales, a change in gross profit margin, or a change in operating expenses as a percentage of sales. The results indicated that the firms who implemented TQM had a significant increase in net income. As such, an examination was conducted on the variables that influence net income. As expected there was a positive correlation between a change in sales and the implementation of TQM. However, the regression analysis indicated that TQM was a small predictor ($R2=.035$ @ $p<.05$) of the overall variance in sales. Also, the results indicated that there wasn't a significant correlation between the implementation of TQM and a change in gross profit margin (as a percentage). For the most part, this suggests that while sales were increasing, the cost of goods sold were increasing or decreasing on an inconsistent basis. The most important finding, however, was that operating expenses as a percentage of sales had decreased with the implementation of TQM. And, that the implementation of TQM appeared to be associated with a large part of the variance in operating expenses ($R2=.21$). This finding is significant and suggests that the implementation of the TQM constructs is associated with a more efficient operation. Also, importantly, the findings indicate a significant relationship between both the TQM aggregate and number of TQM implementation years constructs with customer satisfaction. Additionally, as hoped, both the TQM aggregate and number of TQM implementation years constructs correlate significantly with increased sales (as a percentage).

CONCLUSIONS

This research provides a test instrument and an empirically reliable framework to evaluate an organization's TQM implementation. The research findings provide definitive evidence that TQM implementation is a significant predictor of customer satisfaction and a weak but significant predictor that TQM is associated with the improvement of several financial variables. Further, the regression analysis revealed that "continuous improvement tools" is the best predictor of a change in net income and that "internal cooperation and open organization", "support of top management", and "customer focus" are the best predictors of operating expenses. Also stepwise regression analysis indicated that "top management support" and "product improvement" are the best predictors of customer satisfaction. Additionally, this research confirms the proposition that the duration of TQM is positively correlated with both financial and strategic variables. Further, the TQM aggregate score (combined factors) gets stronger with age or continued emphasis. Lastly, the findings suggest that the impact of the TQM variables on performance is not significantly different across organizational size and industrial specialty. This is particularly exciting and suggests the robustness of the TQM philosophy.

Note: detailed references are available upon request from cemery@lander.edu.

DIVERSIFICATION STRATEGY IN ELECTRIC UTILITIES: WHO WINS? WHO LOSES?

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ABSTRACT

We know diversification as a widely prominent strategy for pursuing organizational growth. For decades managers have been enamored with prospects for market power, economies of scope, risk diversification, and mere size and visibility resulting from diversification initiatives. Diversification strategy involves both the scope of the organization defined by industries and markets it competes in (which can be related or unrelated), as well as the vehicles – acquisition, start-up, or joint venture/strategic alliance – used to enter these industries and markets (Bergh, 2001). The allure of diversification can be especially compelling when an organization's core business appears to offer limited growth opportunities, and financial resources are available for acquisition purposes (Park, 2003), resulting in a strategy of unrelated diversification via acquisition (Chatterjee & Wernerfelt, 1991).

Such are the circumstances in the electric utility industry today. While deregulation is evolving in some states, the industry remains characterized by legally protected service territories which limit geographic expansion. Past promotional efforts to encourage increased electricity use have been curtailed by regulatory pressures to emphasize energy efficiency. Consequently, most electric utility companies can only experience the natural growth stemming from increased population or commercial and industrial activity in their territory, estimated at 1.3% nationwide through 2010. As exclusive providers of an essential service, electric companies do enjoy a continuous revenue stream, stable operations, and steady profits afforded by state-regulated rates. Profits and borrowing power enable electric utilities to acquire new lines of business offering both higher growth prospects and defensive options in the face of deregulation uncertainties. Thus, increasing diversification of electric utility firms has been a notable industry trend for the past ten years (U.S. Industry and Trade Outlook, 2000).

The poor performance of diversification strategy, especially unrelated acquisitions, is well documented (Barney, 2002; Markides & Williamson, 1996; Mansi & Reeb, 2002; Porter, 1987; Rajan, Servaes, & Zingales, 2001; Wright, Kroll, Lado, & Van Ness, 2002). Accordingly, many stakeholders including consumers, municipalities, regulating bodies, and investors are concerned about the levels of electric utility diversification. Failed diversification strategies in this industry can affect far more than the profitability of a firm; rates paid by captive customers, reliable electric service, industrial development, and community growth may be impacted. Moreover, electric utility companies have traditionally been pillars of the community, providing a stable source of good jobs and active community involvement. Electric utility company stock also carries a reputation of stable value plus high dividend return, so is prevalent in retirement portfolios. Considering the disappointing outcomes of diversification in other industries, its growing prevalence in the electric utility industry warrants attention.

This study examines diversification within the electric utility industry in four upper-Midwestern states. All ten investor-owned utilities (IOUs) and five of the largest rural electrical cooperatives (RECs) in each of the four states are included in the study. Annual report data from these 30 electricity providers are analyzed to identify each company's diversification strategy and *performance outcomes. Results indicate that IOUs are far more diversified than RECs, and that intended diversification strategies are not always realized. Reasons for the varied strategies and successful vs. unsuccessful outcomes are explored, and the differential impact on specific stakeholder groups is examined. The study concludes with recommendations for diversification strategy in the electric utility industry, and suggestions for improving future research through data refinements.*

EVOLUTION OF INTERNATIONAL CORPORATE GOVERNANCE IN NEWLY PRIVATIZED COUNTRIES

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ABSTRACT

As U.S. corporations grapple with the implications of the Sarbanes-Oxley Act and the new legislative requirements imposed on them, state-owned firms in former communist economies and developing countries are similarly wrestling with how to best move to a form of corporate governance that will best serve them in a privatized economy. We examine and compare the corporate governance issues surfacing in each of these very different scenarios. We conclude by extracting relevant governance lessons and implications that policy makers and corporations could learn from other economies despite the disparity of forces driving their renewed interest in corporate governance.

INTRODUCTION

The United Sates has been a free market economy since it's inception over 200 years ago and is the world's largest economic powerhouse. Yet U.S. corporations and U.S. government have shown a Laissez-Faire attitude towards business and a serious lack of emphasis regarding basic issues of corporate governance policy, regulations and procedures. With the recent major corporate scandals of Enron and WorldCom, U.S. corporate governance systems efficiencies are being questioned once again. However, given recent legislation like Sarbanes-Oxley, the U.S. system is arguably one of the most proactive in taking steps to improve its corporate governance and is a leading industrial nation with its current corporate governance system.

While the debate over the efficiency of the governance system in the major economies around the world will continue, Denis (2001) states that the more important evolutions in corporate governance will be those of many lesser-developed countries who try to implement lessons previously learned by U.S. corporations. But the privatization movements cannot follow major industrial nations given their unique institutionalized histories. For example, Aggestam (2004) argued that the Polish versions of capital groups are markedly different from their western counterparts as they reflect unique historical patterns and socio-economic environments. Likewise, following the large-scale privatization process in Central and Eastern European countries, these transition economies have seen more restructuring in these countries motivated by political and institutional changes and less so by market forces (Filatotchev, Wright, Uhlenbruck, Tihanyi, and Hoskisson, 2003). Hence, for newly privatized nations this added complexity in the corporate governance mechanisms creates additional uncertainty with investors. The research question is, "What can be learned from the differences in corporate governance systems between major U.S. corporations and actions of a newly-privatized Mongolian company?"

LITERATURE REVIEW

Clark, Garner, Grace Jr., Haupert and Roath (2002) argue that there has been a major change in practices to ensure good management and adequate controls. The change is the result of a shift in focus from the strong CEO influence on Boards of Directors to an improved set of checks and balances among the five fundamental elements of corporate governance: the board, the audit committee, senior management, internal controls, and the external auditor. This literature review attempts to define the major changes in corporate governance rules, regulations and theory since the Enron and WorldCom scandals using Clark, et al's. (2002) five fundamental elements of corporate governance as a framework.

First, this paper will look at Board of Directors research. Cox et al. (2002) states that the most important responsibility of the board of directors is the implementation and operation of the corporate governance process. Most research on board effectiveness has concentrated on the relationship between board structure and firm performance with ambiguous results (Huat and David, 2001). Researcher opinions vary about the effectiveness of inside versus outside directors with some believing that the outsider's objectivity and openness to new ideas is a strong advantage, while others believe outsiders do not have enough understanding and expertise about the company to have a positive influence (Huat and David, 2001). In the area of CEO-chairman duality, some researchers argue that elimination of the CEO as chairman will have positive effects and lead to increased effectiveness of board monitoring (Rechner and Dalton, 1991), while others believe that having the CEO as the chairman will provide strong leadership and internal efficiencies through unity of command (Donaldson and Davis, 1991).

The current legislation seeks to influence these ongoing debates by shifting the center of governance responsibility from the CEO to the directors and requiring a greater percentage of independent directors sitting on the board. Independent directors must have no previous family ties or business ties to the management of the organization. Additionally under the new laws, directors have much more liability and culpability for failure, thus causing directors to reevaluate their responsibilities, values and how much time they are spending on them (Marshall, 2002).

Next, the audit committee is an internal control measure and is formed from the current membership of the corporation's board of directors. Improvement of audit committee controls is at the forefront of reforms on oversight under the Sarbanes-Oxley Act and stock exchange rules. Revised and very specific governance standards in the appointment of audit committee members and the execution of audit committee duties have resulted in a checklist including, but not limited to, a requirement for at least one member of the committee with financial or accounting expertise, a charter certifying audit committee independence from top management, more audit committee controls over the external auditor and required review of financial controls and results (Guy and Zeff, 2002). A lack of financial expertise on audit committees has been cited as the second most important factor in the fall of the Enron Corporation (FEI Task Force, 2002). Cox, et al. (2002) agrees with these new detailed rules stating that the committee's independence and technical competence is extremely important to a fair and impartial audit.

The major governance issues surrounding senior management are executive compensation and ethics. Executive compensation can be further subdivided into two overriding issues; the level of executive pay and the type of pay for performance (salary and/or stock). Denis (2001) argues that, from a corporate governance perspective, the sensitivity of pay to performance is the most important issue.

As a result of potential misconduct, many of the specific requirements of the Sarbanes-Oxley Act (SOX) have significant impact on the governance activities of senior management. Probably the most highly visible aspect of SOX is the requirement for the CEO and CFO to certify quarterly and annual financial reports. As such, company officers can be held criminally liable for required restatement of results that are caused by fraud and/or misconduct. Most loans, once offered by the company to executive officers, are now banned and many restrictions have been placed on other transactions made by the executives.

In the area of ethics, Sox directs the SEC to require each company to publicly disclose whether or not they have adopted a code of ethics and to disclose the contents of that code if it has adopted one. If the company had not adopted a code of ethics, they must also disclose this and, more importantly, why they haven't. Additionally, this code of ethics must be broad enough to cover all senior management officers and specifically includes the CEO and CFO (Hamel, 2003; McElveen, 2002).

The FEI Task Force (2002) report noted that another factor leading to the fall of Enron was failure of the external audit due to compromised independence and failed quality control procedures. There are many who believe that the tragic and immediate implosion of the Enron Corporation was a direct result of a collusive relationship between the external auditor, Arthur Anderson, and the executive officials of Enron.

Next, this research will explore an illustrative case of privatization in Mongolia for the firm Gobi JSC and draw parallels with the Sarbanes-Oxley requirements. Since 1990, Mongolia has moved rapidly to establish a market-oriented legislative framework. The program of privatization of state property for 1992-1996 set out the legal basis for privatization. As part of the privatization phase in 1995, the Government privatized 25% of the Gobi Company on the publically available Mongolian Stock Exchange. As a result, Gobi Corporation was a 75% state-owned shareholding company in 2003. Gobi JSC is a pioneer of modern cashmere manufacturing facilities in Mongolia. In 2003 it was one the top five cashmere producers in the world and the second largest company in Mongolia.

The administrator of the state property, the SPC, originally appointed 75% of the board of directors (BOD); and the public, owners of 25%, nominated and appointed their own candidates as well (Table 1). Changes in the Company Law in 2000 required the BOD seats to be at least 9. The shareholder meeting of Gobi, according to the law, declared the size of BOD to be 10 in 2000, compared to 7 in 1997 (see Table 1). They are all outside, external and independent directors, while Sarbanes-Oxley (SOX) has no set requirements on proportion of outside directors. Gobi's BOD cannot be senior officers, however, under SOX the BOD can include senior officers.

Table 1:
Gobi's Ownership and Control %

Shareholder type	Ownership	Control	
		1997 year	2000 year
State	75%	5 seats 71%	7 seats 70%
Public	25%	2 seats 29%	3 seats 30%
Total	1	7 seats 100%	10 seats 100%

State property representatives on the BOD are drawn from the government departments, while the public elects their own representatives through the shareholder meeting. All the directors hold graduate degrees in management related subjects, operations management, economics, or law. They are usually selected because of their reputation and professional expertise. The BOD's nominating committee formulates the selection criteria such as education, management experience, professional expertise, and reputation, while shareholders control the selection process and voter rights. Civil service rank and the government hierarchy plays an important role in assessment of their performance. The assessment is based on such indicators as profits, discharge of social obligations, and tax receipts. In other words, directors are held accountable for the company's performance.

The Gobi shareholders control the allowances and compensation incentives linked to company performance on particular target measures. Salary is the main form of compensation, and remuneration is based on the same criteria as directors, performance on the target measures. The BOD evaluates executive managers based on total profit of the company, taxes paid, return on equity, and performance of BOD decisions. The bonus is about the only incentive component in the compensation contract. However, the willingness to work for the well being of the company and its employees within the administration and political hierarchy is also considered. Thus, to a significant extent, there appears to be a concerted effort to link directors' compensation and various measures of company performance. However, equity based compensation is not allowed for senior officers of Gobi, as it is under SOX. Thus, accountability of senior officers can be looked at through slightly different lenses.

The traditional combined roles of the chairman and chief executive and dependent directors' positions led to potential abuse and exercise of discretionary powers with lower overall effectiveness and profitability of the company. To address this problem, the SPC separated the roles of chairman of the board and chief executive manager in 1997, and gave the chairman's post to an independent director; also, the SPC appointed independent directors and independent auditors to the auditing board. This solution improved functional effectiveness and organizational productivity. Gobi also requires a Code of Ethics and SOX requires the adoption of a code of ethics for senior financial officers particularly related to conflict of interest. Additionally, senior officers of Gobi and under SOX have some administrative accountability with criminal consequences including fines and personal and criminal liabilities. For example, under SOX the penalties can be fines up to $5 million and 20 years in prison.

Internally, the BOD creates committees (executive team under BOD member) for each project, depending on the issue, to get a comprehensive picture in order to facilitate knowledgeable decisions and to improve productivity. Thus, insiders at Gobi do provide relevant information. Both Gobi and SOX require all material off-balance sheet transactions be disclosed. Also, Gobi disallows the firm from extending credit to any BOD member or senior officer while SOX does make some exceptions (see Table 2). While Gobi does allow its Directors to own stock, its senior officers and other current employees can have no equity compensation in the company. In contrast, Directors and senior officers in the U.S. may own stock in the firm and are often encouraged to do so in hopes that it will increase attention to shareholder value.

According to the Company Law in Mongolia, the Auditing Board for Gobi consists of three representatives. The State Property Committee appoints two members, and public shareholders elect 1 supervisor to the board as well. All auditors have a graduate degree in economics and accounting, while the requirements for SOX only require that Audit Committee members must have an understanding of financial statements. Like the board of directors, all auditors do not have any positions in the company and they are independent. These auditors are external, but they do not have any obligation to BOD, like supervising committees or auditing committees in U.S. counterparts. The following table (Table 2) selectively summarizes the comparative governance requirements for U.S. firms under Sarbanes-Oxley and for large privatized firms in Mongolia.

Table 2: Sarbanes-Oxley vs Privatized Mongolian Corporate Governance Requirements.

Governance Category	US Corporate Governance Requirements after Sarbanes-Oxley	Corporate Governance Requirements For Privatized Mongolian Firms*
Board of Directors	No requirements for proportion of 'Outside' directors.	All Directors are 'Outside', however , the govt appoints % of directors.
	Directors are never nominated from competing firms.	Shareholder elected directors can be from competing firms.
	Directors can be held personally liable for fraudulent activities.	Directors can be held personally liable for fraudulent activities.
	Directors can own company stock.	Directors can own company stock.

Table 2: Sarbanes-Oxley vs Privatized Mongolian Corporate Governance Requirements.

Governance Category	US Corporate Governance Requirements after Sarbanes-Oxley	Corporate Governance Requirements For Privatized Mongolian Firms*
	Directors can be replaced by board or shareholders, but no formal performance assessment of directors is conducted.	Performance assessment of directors based on corporate profits, discharge of social obligations, and tax receipts.
	Directors can be senior officers	Directors cannot be senior officers
	All BOD decisions reported to shareholders	All BOD decisions reported to SPC
	Vote by shareholders required to remove a director	SPC removes poorly performing directors
	Directors approve senior officer decisions to issue further stock	Further privatization of company requires authorization of SPC
BOD Audit Committee	Audit Committee directly responsible for appointment & compensation of external auditors.	External Auditors appointed by SPC or State Auditing Committee
	All audit committee members are BODmembers and not Senior Officers.	Auditing Committee cannot be directors or Senior officers
	Audit Committee members must be replaced every five years.	Audit Committee member replacement schedule depends on company charter, but usually every 3 years
	Audit Committee members must have understanding of financial statements.	Audit Committee members have degree in accounting, CPA, and auditing experience
	Audit Committee Charter must certifyindependence from Senior Officers.	Audit Committee, due to SPC memberAppointment, completely independent of both directors and senior officers.
Senior Officers	1. CEO & CFO certify each annual and quarterly audit report. 2. Establish & maintain internal controlsthat ensure material information ismade known to other officers. 3. Disclosed any internal controldeficiencies or changes to auditors & BOD Audit Committee.	Same
Assessment Ctrl	Equity-based compensation allowed.	No equity-based compensation allowed.
Compensation	CEO & CFO forfeit incentive-based or equity-based compensation for 12 months if accounting restatementrequired.	No compensation-based fines, but can be Replaced by SPC or Directors
Penalties	Adopt a code of ethics for senior financial officers particularly related to conflict of interest.	Code of Ethics required. Written into the contracts for senior officers
Ethics	Destruction, falsification, or alteration ofmaterial documents or certification due to misconduct; or obstruction of investigations; or security, wire, or mail fraud perpetrated by senior officer or BOD members subject to fines of up to $5M and 20 years prison.	Subject to fines, criminal liability, and prison time, but no maximums.

Table 2: Sarbanes-Oxley vs Privatized Mongolian Corporate Governance Requirements.

Governance Category	US Corporate Governance Requirements after Sarbanes-Oxley	Corporate Governance Requirements For Privatized Mongolian Firms*
Internal Controls	Unlawful for firm to extend credit to anyDirector or Senior Officer except for home improvements & manufactured home loans, charge cards, or extension of credit by securities broker.	No credit of any kind available to directors or senior officers.
	Directors & Senior Officers who directly or indirectly own more than 10% of stock must file public statements about any changes.	No equity compensation allowed.
	Cannot perform non-audit services for corporate clients except tax services and those pre-approved by BOD AuditCommittee of client.	SPC performs annual audits and inister of Finance performs audits every 3 years. Private auditors do not independently conduct audits of privatized firms.
External Auditor Independence	Non-audit services will be disclosed to shareholders	Same
	Lead Auditors cannot have performed audit services for same client in every audit of 5 consecutive previous years.	Appointed by SPC, but no such requirements.
	All communication with Senior Officers will be reported to BOD AuditCommittee	Same

* For former state-owned large firms. ** State Property Committee

IMPLICATIONS

As U.S. corporations grapple with the implications of the Sarbanes-Oxley Act and the new legislative requirements imposed on them, state-owned firms in former communist economies and developing countries such as Mongolia are similarly wrestling with how to best move to a form of corporate governance that will best serve them in a privatized economy. As addressed in this paper, despite different forces driving a renewed interest in corporate governance, lessons can be learned from the other.

It is clear that privatization in countries such as Mongolia is in the early phases with significant state control and influence still in place. Veteran private market observers may see this as both unnecessary and actually detrimental to the performance of such firms. A number of reforms as suggested by current U.S. corporate governance policies might be useful as further privatization occurs and the proportion of state ownership recedes. One such reform is allowing directors and senior officers to own stock in their firm. Agency theory research suggests that this provides incentives for these governing members to view firm performance more from the perspective of shareholders with less likelihood of self-aggrandizement. Many would argue as well that this would be a further incentive for senior management to focus on creation of future revenue streams as well as current performance.

A second potential mechanism that U.S. corporate governance approach could offer to further privatization efforts is the greater weight placed on competitive independence from other firms than on interest is obtaining industry expertise for the board of directors. Privatized corporations in Mongolia allow employees from competing firms to be on the boards of directors of competing firms. While industry experience may be important, this enables firms to more easily collude and signal competitive actions and planning to each other. This dilutes the ability of competitive forces to drive improvements in firm performance and effective competitive actions. This may not only hamper efficiency of domestic industry, but also quality of decisions made regarding foreign markets or competitors. A chapter should be taken from U.S. firms by prohibiting directors to be selected from competitors to further enhance the benefits of privatization in the Mongolian economy.

From a corporate governance perspective, however, there are also some potentially valuable lessons that could be learned by the U.S. corporations and policy makers from the privatization phenomenon in other countries. The first lesson is the issue of the structure and make-up of the board of directors in relation to the percentage of inside and outside directors. The boards of directors of privatized Mongolian corporations are made up of entirely outside directors. It is true that the majority of these are appointed by the government, but the principle of complete board independence is one that has likely not been implemented in any U.S. corporations. It is often argued that inside directors provide an understanding of company operations and senior officer strategy only inside experience can bring to the board. It could also be argued, however, that directors with considerable business expertise and experience in the industry and elsewhere is sufficient for such an assessment and it is more likely to force senior management to provide a clear explanation of their decisions and planning rather than being able to assume taken-for-granted past logic.

Second, further independence of corporate performance assessment is suggested by the complete independence of the audit committee in privatized Mongolian firms from both the directors and senior management. This enables internal auditing to achieve the independence of external auditors, perhaps even more. The difficulty in transferring such a policy to the U.S. is identifying what organization would substitute for the government in appointing audit committee members. An additional strength, albeit more costly, Mongolian policy is the requirement that audit committee members have accounting degrees, CPAs, and have auditing experience. A similar requirement posed in the original Sarbanes-Oxley legislation was later diluted to the current requirement of someone with "financial expertise" who would be far less costly, but also likely a far less effective audit committee member.

Lastly, while Mongolian firms might consider allowing stock ownership to provide a greater incentive for senior managers (directors already can) to behave in the interests of shareholders, corporate governance policy in the U.S. might also consider Mongolia's direct performance appraisal of directors. Shareholders could vote on a performance system to be implemented. This places far greater accountability on board members. It is likely, however, that such a reform would have to be initiated by the federal government as no firm would implement such a system on its own for fear of being placed at a relative disadvantage.

In conclusion, it can be observed that widely varying experiments and reforms in corporate governance are being implemented in diverse economies around the world. We have provided a sample of such innovations from two very different economies, the U.S. and Mongolia. Both are struggling for different reasons with the same classic governance dilemma—balancing the discretion of senior management to effectively run a company with protection of shareholders interests through an effective, independent, and accountable board of directors. In the U.S. case this reform is driven by the failure of current corporate governance policy and in the Mongolian case is driven by the need to have a substitute for government control of internal corporate operations. Whatever the motives, governance policy makers and publicly-traded corporations could benefit from dropping the "not-invented-here" attitude and openly consider governance innovations in other economies.

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STRATEGIC MANAGEMENT, BLIND SPOTS AND INDIVIDUAL RISK PERCEPTION

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ABSTRACT

The strategic management process used by a firm can benefit from a better understanding of risk perception and how those perceptions influence strategic decision-making. The risk management process is presented as a decision aide that a business can utilize to make more informed decisions. Blind spots can lead to faulty judgment that prevents businesses from making better choices. Rather than making optimal choices, managers make choices that satisfy our perceived needs without necessarily exhaustively searching for optimal solutions. Perception is limited by our information processing capability, experience and individual blind spots. These limitations are explained by behavioral decision theory and the how the attendant heuristics can lead to unanticipated and irrational decisions. An awareness of behavioral decision theory can allow a business to avoid the blind spots and make more informed choices.

THE PROBLEM OF STRUCTURE IN MULTINATIONAL CORPORATIONS: A STUDY OF CONTINGENCIES

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ABSTRACT

The growing geographical reach of multinational corporations has raised some important structural issues for theorists and practitioners of international business, many of them related to the issue of control. This problem is intensified by an important paradox: while most empirical research suggests that diversified firms need decentralized control systems, some studies also contend that singular strategies need to be developed to exploit synergies in the homogenizing world market. In this paper, we attempt to resolve this paradox by studying contingencies such as level of centralization, reward systems, transfer pricing, and the geographic and technological contiguities within MNCs.

We offer a number of propositions to identify situations in organizations that call for an approach of centralization and others that favor a more decentralized approach. Ultimately, following Chandler (1962), we delineate the manner in which structure follows strategy in an organization's progress and geographic spread.

INTRODUCTION

Researchers in the field of international business continue to grapple with the issue of control of the multinational corporation (MNC) (Birkinshaw, Toulan & Arnold, 2001; Earley & Mosakowski, 2000; Hamilton & Kashlak, 1999). This field of inquiry has an organic link with much of the 'content' research in strategic management. In particular, it draws substantially from prior research on the relationship between diversification and performance (Hill, 1994; Rumelt, 1974, 1982; Wernerfelt & Montgomery, 1988).

Typically, the issue of control in a MNC may be defined in terms of the paradox of having to design newer and tighter control systems in an atmosphere which celebrates decentralization (Simons, 1995). Many studies have posited that as the firm increases in size and diversity, the relationship between the corporate headquarters and the subsidiary needs to be decentralized (Jones & Hill, 1988; Vittorio, 2000). However, it is also true that the increased globalization of firm operations necessitate the development of a coherent, singular corporate strategy treating the world market as a single entity with globally interchangeable production and marketing operations (Drucker, 1986; Hout, Porter & Ridden, 1982). It therefore appears that the MNC is stuck in a paradox of having to hold tight and to let go at the same time.

In this paper, we attempt to resolve this paradox by discussing a number of contingencies associated with the control of the MNC. We begin by drawing from the literature on diversification of the multibusiness firm to develop a better theoretical sense of the control issues faced by MNCs. We then suggest four sets of contingencies that need to be taken into account while designing control systems for MNCs. These contingencies include whether or not the subsidiaries of the MNC are interdependent on each other, whether or not they transfer goods from each other on a regular basis, whether or not the headquarters possess the ability to monitor their actions, and whether or not these subsidiaries are geographically and technologically linked to each other. Based on these contingencies, we advance a series of propositions about the control of the MNC. We conclude with a discussion on the implications for implementing control systems based on these conclusions.

CONTROL OF THE MULTIBUSINESS FIRM: AN OVERVIEW

Current research on the control of MNCs has always tended to focus on contingencies that make MNCs different from domestic corporations. For example, theorists have discussed that MNCs need different control systems because of their deployment of technology (Vittorio, 2000), of the level of task complexity within the firm (Muralidharan & Hamilton, 1999), of diversities of national culture (Hamilton & Kashlak, 1999) and of accounting systems (Birkinshaw, Toulan & Arnold, 2001). Sometimes have critiqued the confusing plethora of contingencies and contradictory findings on the issue (Taggart & Hood, 1999).

While these discussions are important, we feel that instead of proceeding directly to the issues that face the MNC, it would be more profitable to engage in a more general theoretical discourse. In other words, we would benefit by first examining the theoretical issues that underpin the control of any corporation, and then gradually build in the issues that make MNCs special.

When studying the general issue of the control of the multibusiness firm, we can see that it is closely related to studies of diversification as a strategy, especially the impact of diversification on organizational processes and systems (Bettis and Hall, 1981; Pitts, 1977). While some theorists saw related diversification as the key to better organizational control (Rumelt, 1974), others found similar support for unrelated diversification as well (Michel and Shaked, 1984).

Theorists studying control relationships in the multibusiness firm often focused on headquarter-subsidiary relationship in diversified corporations as the crux of the control issue. They tended to follow three distinct, if inter-related directions, which we have chosen to name the structural control school, the intra-corporate school, and the transnational school respectively.

The structural control school predominantly concentrated on the relationship between strategic business units (SBUs) that the headquarters of a corporation could foster (Hill, Hitt & Hoskisson, 1992; Hill & Hoskisson, 1987; Kerr, 1985; Vancil, 1980). These theorists were inspired by the structural contingency models adopted in traditional organizational theory (Lawrence & Lorsch, 1967), and also by the writings of the early business historians (Chandler, 1962; Sloan, 1963), who observed the need for a balance between functional specialization by the SBU and "centralized oversight" by the headquarters as the key to the management of the diversified firm. The primary conclusion reached by this strand of research was that related diversified organizations, which seek to exploit corporate economies of scope, would be better served by cooperative arrangements between SBUs, while unrelated diversified firms, in their quest for internal governance advantages, would profit more from inter-SBU competition.

The intra-corporate school was more concerned with evaluating the level of openness, subjectivity and trust that could be incorporated into the corporate-SBU relationship without loss of control. Drawing from Porter (1980), Rothschild (1979) and the Miles and Snow typology, this strand of research focused on a variety of control-related factors deployed by the corporate headquarters, such as incentive systems (Govindarajan, 1988), inter-SBU resource sharing systems (Gupta & Govindarajan, 1986), corporate-SBU relations (Gupta, 1987), socialization of new entrants (Goold & Quinn, 1990) and the choice between behavior based and outcome based control mechanisms (Govindarajan & Fisher, 1990).

The primary conclusion of this school is that open systems profit more from subjective, cooperative and trust-based inter-SBU relations, while closed systems are better served by objective, competitive and contractual inter-SBU relations.

The transnational school is the one that takes these conclusions that are generic to all businesses and locates them in MNCs. Scholars of this tradition contend that the structure of the diversified MNC is fundamentally influenced by its size and its level of diversity. MNCs operate in conditions of great complexity, both with respect to their product range and their geographic spread. Thus, they need to experiment with a hybrid mixture of structures, including functionally specialized sub-units, matrix organizations, divisionalization, and occasionally, centralization (Taggart, 1998; Melin, 1992; Prahalad & Doz, 1985). At the level of human resources, transnational scholars stress the need to create “hybrid cultures” which may also be viewed as proxy control mechanisms (Earley & Mosakowski, 2000).

When studying the general issue of the control of the multibusiness firm, we can see that it is closely related to studies of diversification as a strategy, especially the impact of diversification on organizational processes and systems (Bettis and Hall, 1981; Pitts, 1977). While some theorists saw related diversification as the key to better organizational control (Rumelt, 1974), others found similar support for unrelated diversification as well (Michel and Shaked, 1984).

CONTINGENCIES OF CONTROL

One of the fundamental paradoxes associated with control of the diversified corporation is that of the tension between size and complexity. On one hand, we have to deal with the perceived globalization and the ensuing homogenization of large markets (Drucker, 1986, Ohmae, 1990), which demand that global organizations need to develop coherent and singular strategies (Hout, Porter and Ridden, 1982). On the other hand, the growing heterogeneity and independence of consumer preferences need to be matched by creating autonomous and flexible subsidiaries. Studies have shown that centralized structures will render organizations unresponsive, overloaded at the top and demoralized at the bottom (Birkinshaw and Morrrison, 1995). Partially centralized structures, geographic divisionalization and product-market based divisionalization are all inadequate responses to this double-bind. To be sure, the M-form organization, with its emphasis on functional specialization, represents a catch-all structure for all modern firms, but we need to explore the finer aspects of control within the M-form structure.

There are four major disadvantages associated with excessive centralization in an MNC (Egelhoff, 1988);

- Overloading of the decision-making capacity of the top management team.
- Time lost in moving information up and down the hierarchical structure.
- Negative impact of corporate centralization on SBU-level motivation.
- The unavailability of specific information at the top level.

On the other hand, it has been argued that greater interdependence between national subsidiaries may require greater dependence on the top management team as a coordinator in inter-SBU transactions (Govindarajan, 1988). The notion of the top management as a policeman gives way in such a case to the notion of top management as a resource allocator or facilitator. Multinational corporations have been making unique adjustments in order to address this paradox. For instance, in the field of international business, scholars have theorized the manner in which multinational corporations (MNCs) are moving from centralized to network-based structures (Malknight, 1996). [At this stage of the paper, we advance a series of propositions that explicate on organizational contingencies. The authors will be glad to provide a full version of the paper upon written request].

DISCUSSION

In this paper, we identified the fundamental control issue facing the MNC as a paradox: it has to hold on and let go at the same time. The issue is, when should it hold on (centralize its control systems) and when should it let go (treat each of its sub-units as autonomous companies in their own right)?

We addressed this issue first by examining the general literature on the diversified multi-business corporation. We concluded from that analysis that the fundamental issues in the control of the diversified corporation pertain to the relationship between the headquarters and the SBU, which could be seen as a quasi-agency relationship. Based on these findings, we examined several contingencies faced by the MNC, which in turn suggested a variety of different control arrangements. For example, when the SBUs (subsidiaries) of an MNC are interdependent, control systems need to be centralized, to coordinate proper communication between them. When the SBUs operate relatively independently, control systems need to be decentralized. Similarly, at the level of incentive and reward systems, we argued that when a subsidiary is engaged in tasks that are not clearly observable by the headquarters, it would be better for the headquarters to reward the subsidiary on the basis of outcomes. However, when the subsidiary is clearly visible to the headquarters, and when its actions have potential implications for other subsidiaries, behavior-based reward systems would be more suitable. We also suggested that the headquarters of a corporation should mediate in transfer pricing issues between subsidiaries only when the transaction between subsidiaries has a longer time horizon. For once-off transactions, it would be best to let the subsidiaries treat it as a market transaction. Finally, we suggested that the control systems devised by an MNC should be a function of whether or not the subsidiaries are geographically and technologically contiguous.

The motto of the MNC also appears to be to achieve total control of all subsidiaries at the financial level (financial control in MNCs is being centralized to a great extent), while making more and more concessions to decentralization in other spheres (such as brand management, distribution and even manufacturing). This dual policy of simultaneous centralization and decentralization is rendered possible due to the vast improvements in information technology that make it possible to store vast quantities of data, transfer it in split seconds across continents and engage in continuous feedback. However, it will also be able to develop more decentralized indicators (such as regional and country level ROS figures), compare them against one another and against budget, determine which regions and countries are performing well or under-performing, and develop monitoring systems to make sure that performance does not stray from projections. Such centralized indicators are extremely useful at the level of financial data, but do not necessarily work at the level of other data such as market share of productivity due to inherent heterogeneities (the products might be mature in one market and just being introduced in others, some plants may be better equipped to take advantage of economies of scale than others etc.). Thus, the paradigms of centralization and decentralization have to be deployed selectively across the subsidiaries of MNCs for optimal performance.

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JAPANESE MANAGEMENT: THE FIT FOR PROJECT MANAGEMENT

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ABSTRACT

This paper begins with a description of some of the attributes of Japanese management. Heavily influenced by its cultural and historical setting, Japanese management is characterized by extensive team building, networking, tsuikiai an emphasis on trust, informal as opposed to formal work roles, and interpersonal relations. The value placed by Japanese business is then compared to the theory and practice of formal project management. A conceptual and practical parallelism is found to exist between the two, and Japanese management exemplifies a number of the human resource management prescriptions given in project management best practices. The potential interest of this research is to take two maturing literature streams in management that have not formally been compared, and to note similarities and areas of agreement between them. It is concluded that Japanese management, aside from presenting a number of HRM prescriptions for general management, is also particularly apt for application to project management. Further applications in the area of systems thinking and management are suggested.

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