

Control mechanisms of MNEs: an empirical study

Control
mechanisms
of MNEs

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Received 17 July 2016
Accepted 18 July 2016

Abstract

Purpose – This purpose of this paper is to explore variations in the extent of control mechanisms, according to country of origin and organizational characteristics, in a challenging country of domicile.

Design/methodology/approach – A survey research design involving the use of a questionnaire as the primary data source was adopted. A total of 350 subsidiaries were initially randomly selected and contacted in person, or via telephone and e-mail, of which 147 agreed to take part in the study and responded to the survey.

Findings – The authors find that Multinational Enterprises (MNEs) from highly financialized Liberal Market Economies will be associated with a greater reliance on formalized control mechanisms; this will enable the MNE's headquarters to closely monitor subsidiary managers according to objective measures, to ensure that the maximum shareholder value is released.

Research limitations/implications – This study reveals a greater reliance on control mechanisms in larger firms, reflecting a desire to maximize bureaucratic economies of scale.

Practical implications – The authors find that the presence of expatriates regardless of country of origin leads to greater decentralization, suggesting foreign firms do not trust local staff.

Originality/value – This is one of the few studies of this nature conducted for the region of Middle East – and the only one the authors are aware of for Saudi Arabia. Further, it sheds new light on the impact of contextual circumstances on how closely firms monitor their subsidiaries, the challenges of doing business in the Gulf region and the consequences of the large-scale usage of expatriates.

Keywords Saudi Arabia, Agency theory, Multinational enterprises, Control mechanism, Headquarter–Subsidiary relations, Ordinal regressions

Paper type Research paper

Introduction

How do companies change their internal control mechanisms in response to challenging external circumstances and firm-level responses? This is a study of centralization and control within MNEs operating in Saudi Arabia, one of the last absolute monarchies on earth, which remains a highly challenging environment in which to do business due to insecurity over investor rights, opaque regulations and the capture of entire arms of government by princely entrepreneurs (Ross, 2011; Bradley, 2015). Despite this, the country still holds an attraction for foreign



investors, given its oil and gas riches and its status as the global swing producer. Traditionally, theories of strategies of control have revolved around the views of control as including output, behavioral and normative controls; however, prior research in the area of International Business indicates that the contextual factors of the MNE subsidiary, encompassing not only country of domicile, but also issues such as size, nationality of parent company, presence of expatriate managers and subsidiary function, all impact the relative balance of the management control systems, as well as the degree of autonomy available to the subsidiary (Birkinshaw *et al.*, 1998; Colakoglu and Caligiuri, 2008; Johnston and Menguc, 2007; Fang *et al.*, 2010; Anderson and Holm, 2010). This paper seeks to explore variations in the extent of control mechanisms, according to country of origin and organizational characteristics, in a challenging country of domicile. The remainder of the paper is organized as follows: the next section outlines the context and relevant prior theoretical and applied enquiry; hypotheses are developed in the subsequent section; data collection, variables and methodology are then explained, followed by the analysis of results; finally, discussion occupies the last section.

The Saudi context: regulation and volatility

Although Saudi Arabia ranks quite highly in the World Bank “Doing Business” index (in part, a product of perceived labor market flexibility and the near complete lack of worker rights for a large portion of the workforce), the environment for investors is a challenging one, inter alia, on account of the difficulties of litigation in Saudi courts (Zegars, 2006), and societal dynamics (Rice, 2004). In practice, it has proven difficult to enact the necessary reforms to make the environment more hospitable for foreign investors (Hertog, 2011). Indeed, it has been argued that Saudi Arabia represents an extreme example of the rentier state (Lawson, 2011), and suffers from a particularly chronic resource curse (Auty, 2001). Although in 2014 Saudi Arabia had a gross domestic product per capita of \$18,000, placing the country in the middle- to upper-income category, this is considerably lower than a high of some \$22,000 in 1977, despite high oil prices in the 2000s (Trading Economics, 2015). Moreover, as can be seen from Figure 1, below, this growth has been highly volatile, making it difficult for organizations to plan for the future with confidence, even in the oil and gas industry.

Even when compared to other resource-rich countries, Saudi Arabia has been remarkably unsuccessful in building a developmental state (Auty, 2001; Lawson, 2011;

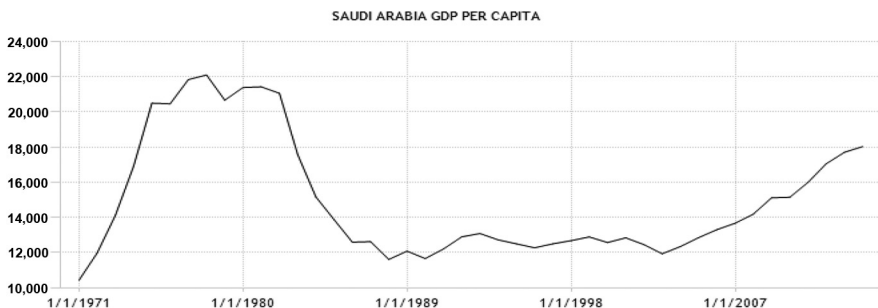


Figure 1.
Changes in the Saudi
gross domestic
product per capita

Source: Trading economics (2015); WWW.trading economics I world bank

Beblawi, 2007). Auty (2001) argues that this reflects Saudi Arabia's role as the key swing producer, and a deeply embedded political culture centering on authoritarian paternalism. This has led to considerable inequality, with between 2 and 4 million out of 16 million native Saudis living in poverty, with high levels of unemployment among the young (*The Guardian*, 2013). Meanwhile, a high proportion of oil and gas rents are captured by possibly as many as 15,000 princes (*The Economist*, 2014), with the Saudi monarch being one of the richest despots in the world. Hertog (2011) argues that key arms of government constitute little more than personal fiefdoms of dominant figures in the regime. Rising fears of instability – and despite a highly repressive environment and political protests – have led to the government accelerating its indigenization policy to create more job opportunities for local nationals. Currently, the country has some 12 million migrant workers, making the majority of those in employment foreign (*The Guardian*, 2013; Jehanzeb *et al.*, 2013). These foreign workers comprise a small minority of highly skilled expatriates, and a large grouping of unskilled and semi-skilled workers. The latter are not readily substitutable with indigenous Saudis, not only (in the case of semi-skilled and skilled occupations) because of a chronic lack of skills, but also because many Saudi firms have founded their competitiveness on a system of quasi peonage, with foreign laborers facing police brutality, confiscation of their passports and arbitrary expulsion as instruments of labor coercion. Hence, although the Saudization policy has been in place for some two decades, it has made only limited inroads in reducing the country's reliance on foreign labor; indigenous Saudis are in a position to insist on better wages and working conditions (Niblock and Malik, 2007).

Ross (2001) argues that in common with other resource-rich autocracies, there are three main mechanisms that shore up the status quo. First, there is the rentier effect, the ability to buy-off key interest groups, in the Saudi case, key fundamentalist religious interests. Second, there is the repression effect, the ability to purchase large numbers of weapons and technologies for mass surveillance (Ross, 2001). Third, there is the modernization effect, with revenue inflows reducing pressures for cultural or economic modernization. Indeed, Ross (2011) suggests: "No state with serious oil wealth has ever transformed into a democracy. Oil lets dictators buy off citizens, keep their finances secret, and spend wildly on arms".

It could be argued that the revenues have increased the range of institutional options, resulting in much variety, from relatively efficient arms of state to corrupt personal fiefdoms and "armies of bureaucratic clients" (Hertog, 2011). Moreover, the Saudi state has accumulated large-scale financial obligations to different interest groupings that are difficult to reverse, authoritarianism notwithstanding. On the one hand, this entrenches state dominance, and yet, on the other hand, makes the state less coherent (Hertog, 2011). Princes serve as intermediaries between commercial interests and the state, allowing innumerable opportunities for corruption, and the blurring of personal royal wealth and state resources (Wilson, 1994).

Within Saudi Arabia, there is a localization policy in place, *Saudization*, which aims to promote the employment of local people through a quota system (Sadi and Al-Buraey, 2009). An initial 2003 goal was to ensure that 30 per cent of employees in firms employing 20 or more workers were Saudi nationals, but this was watered down in 2006 (Tripp and North, 2011). Nonetheless, many firms either chose to close or to nominally employ Saudis as window dressing. In 2011, the Nitaqat system was introduced, a carrot and stick approach that makes it easier for firms that meet Saudization targets to obtain

visas for foreign workers; firms that are red-lined for a lack of progress in Saudization are no longer permitted to renew the visas of their expatriate staff.

Saudization has led to increased job opportunities for Saudi nationals, but chronic skills shortfalls have meant that firms have to employ under-skilled locals (Al-Dosary and Rahman, 2005). The official General Organization for Technical Education and Vocational Training is both overly bureaucratic and ineffective (Al-Shammari, 2009), while the overwhelming majority of Saudis with tertiary education hold degrees in religious studies, with only 20 per cent of graduates holding technical or job-relevant qualifications (Tripp and North, 2011). Again, it means that Saudis with technical qualifications are in very short supply, leading to serious problems with staff retention, as highly skilled individuals regularly job-hop (Al-Subhi Al-Harbi, 1997; c.f. Torofodar, 2011). In turn, this has led to the continued employment of large numbers of expatriates.

In such a challenging environment, MNEs are pulled in different directions. On the one hand, they are under great pressure to employ and advance Saudi nationals, especially those with close links to the princely elite. The difficulties of operating in Saudi Arabia mean that managers who have experience in dealing with local circumstances are particularly valuable (Tripp and North, 2009). MNEs may have an interest in delegating as much as possible to them, given that they are better able to navigate local vicissitudes. On the other hand, local skills shortfalls and the need to ensure that staff follow the interests of the organization, and not some princely patron or other, may drive tighter control from the center.

Forms and practice of control: existing evidence

Agency theorists have proposed that principals tend to use three primary types of control – cultural, behavioral and output – to varying degrees (Ouchi, 1985). Behavior control means that control is achieved by monitoring the behaviors of others, while output control involves measuring the desired quality and quantity of output. Cultural control, however, involves socializing the agent to consider his or her interests as co-identical to those of the principal; however, these are indirectly related in that the use of one method of control may affect the efficacy of another (Chang and Taylor, 1999). Past research has also noted the relative popularity of output control (Egelhoff, 1984) and staffing control – that is, using parent expatriates to fill management positions (Baliga and Jaeger, 1984). These can be viewed as manifestations of cultural control, as they are intended to create a greater sharing of values and goals between the Headquarter (HQ) management and the subsidiary.

Given this, we investigate formal structures of control, as well as how such forces affect – either directly or indirectly – different methods adopted for control and coordination, as well as the requirement for such. With the aforementioned taken into consideration, this research provides a framework model that makes the proposition that a number of different subsidiary features, such as the size and country of origin, are able to affect the mechanisms of control and the degree to which they are applied by headquarters over their subsidiaries located in Saudi Arabia.

Statement of hypotheses

Home and host country effect

A large body of literature suggests that it is not only country of domicile (host), but also country of origin (home), that impacts on firm-level practice (Brewster *et al.*, 2008); the

latter reflects variations in shareholder rights, and the extent to which they may be diluted by the rights of other stakeholders. The literature on comparative capitalism has developed a number of country taxonomies that encompass the countries of origin encountered in this study. First, there is the USA and the UK, held up as quintessential or highly financialized Liberal Market Economies (LMEs), where shareholder rights are most advanced, enabling the latter to most closely direct the policies and practices of the firm (Hall and Soskice, 2001). Second, although the literature has tended to see this category as an internally coherent one (Lane and Wood, 2012), recent writers such as [Konzelmann et al. \(2012\)](#) have pointed to the existence of a second category of less financialized LMEs, including Canada, Australia and New Zealand. The dominance of the financial sector in the first category means that there are even stronger pressures to short-term shareholder value. Third, there are the continental European capitalist (coordinated markets) or “Rhineland” economies, including Germany, Sweden and the Netherlands ([Amable, 2013](#)). Fourth, there are the Scandinavian social democracies, distinguished from their peer coordinated markets by stronger social, but weaker employment, protection and less centralized financial systems ([Amable, 2013](#)). Fifth, there is Japan. While Japan is another example of a coordinated market economy (CME) and has much in common with the two preceding countries, it also has important differences in that large corporations play a particularly important role in providing stability in collaboration with the state, and state welfare and bargaining institutions are less developed ([Amable, 2013](#)). Sixth, there is South Korea, which, while sharing many features with Japan, has very distinct institutional directions given the developmental role of the state during the years of authoritarian rule, and which we treat here as a distinct category ([Whitley, 1999](#)). Seventh, China is often depicted as having a variety of capitalism in its own right, characterized by a much higher degree of state direction than in mature market economies, but also by much internal diversity ([Boyer, 2012](#)). Finally, the Middle Eastern economies have been held to have common features on account of a combination of rapid but volatile growth that has taken place largely despite, rather than on account of, institutional frameworks ([Kuran, 2004](#)).

There is a body of applied work that links country of origin with control. An early pioneer of the literature on comparative capitalism, [Lincoln et al. \(1986\)](#) found that the difference between formal and *de facto* centralization was very minor in American companies but rather more considerable in Japanese companies. [Jain and Tucker \(1995\)](#) assert that power is more centralized in Japanese companies than in American companies in general. [Zaheer \(1995\)](#) found that Japanese banks show higher levels of centralization than American banks, although the difference was not statistically significant. Again, [Kustin and Jones \(1996\)](#) found that the influence of Japanese headquarters on their American subsidiaries was greater than the influence of American headquarters on American subsidiaries. More recent work has sought to distinguish between formal and informal systems of control ([Kim et al., 2003](#)). It has been argued that formal control mechanisms dominate in US MNEs ([O'Donnell, 2004](#)) and implicit control mechanisms in Japanese ones ([Taylor, 1999](#)). A related issue is that Japanese MNEs have a relatively high presence of parent country expatriates in their subsidiaries ([Kopp, 1994](#)), associated with the formation of “mini-headquarters” in the foreign subsidiary, enhancing cultural control ([Baliga and Jaeger, 1984](#)). Similarly, [Ferner \(1997\)](#) found Japanese MNEs were likely to make greater usage of social control,

supported by a relatively high usage of expatriates, while US MNEs favored formal control (Hulbert and Brandt, 2000; Birnberg and Snodgrass, 1988).

Negandhi (1987) found that that 88 per cent of the subsidiaries of American MNEs sampled heavily relied on written policies from headquarters, a much larger amount than those from Asian and European coordinated markets: only 32 per cent of the subsidiaries of German and 12 per cent of the subsidiaries of Japanese firms. Similar distinctions we reencountered between US and Continental European (coordinated market) MNEs (Wolf, 1994), between US and Japanese ones (Jaeger and Baliga, 1985) and between US and French ones (Calori *et al.*, 1994). Research evidence in the areas of attention seeking (Bouquet and Birkinshaw, 2008) and formalization (not investigated in this paper) are less abundant. There is similar broad consensus around *output control*. In an early study, Scholhammer (1971) found that American MNEs relied more heavily on reports than European firms. Confirming this picture, Hulbert and Brandt (2000) found that US MNEs required higher levels of reports than either Continental European or Japanese MNEs (Negandhi, 1987, 1984, 1988).

Given that Britain is also a highly financialized LME, characterized by a high degree of financialization and activist investors (Konzelmann and Fovarque-Davies, 2012), it could be argued that there would be similarly high pressures for formalization to ensure that a value release agenda is adhered to. Formal controls by HQ could include, among others, the degree of standardization the HQ may require from its subsidiary and the kind of rules and procedures that it may exert toward its subsidiary. Hence, we hypothesize that:

H1. Formal control in MNEs from highly financialized LMEs will be higher than that from other capitalist archetypes.

Domestic and third country staff

Given gaps in local skills and capabilities, and quite rapid turnover of indigenous highly skilled staff (Al-Subhi Al-Harbi, 1997; c.f. Torofodar, 2011), firms that employ large numbers of domestic managers may seek to centralize decision making as much as possible. There could be two reasons for this. The first would be that, given high levels of poaching, domestic managers may soon work for competitors, and hence, may face conflict of interest dilemmas. Second, as a result of problems associated with “window dressing”, under-skilled or under-experienced locals may be employed in highly visible positions to meet Saudization targets and/or to win the goodwill of some royal or other, but may not be trusted with real autonomy or vested with meaningful control. This leads to *H2*:

H2. MNEs employing high numbers of domestic staff are more likely to be centralized.

Edstrom and Galbraith (1977) analyzed the international transfer of managers in four multinational companies, one of which transferred a far greater number of managers than its direct competitor – despite their being of the same size, operating in the same industry and having almost identical organizational charts. Further, Edstrom and Galbraith hypothesized that, in that multinational, the transfer of managers was used to socialize managers and create informal verbal international information networks. Others (Ferner *et al.*, 1995; Welch *et al.*, 1994) tested this hypothesis, and found that the usage of expatriates was viewed as a way for individuals to build up networks of

contacts and absorb the international ethos and practices of the firm. In other words, the usage of large numbers of expatriates may be associated with a higher degree of decentralization:

H3. MNEs employing high numbers of third-country expatriates are less likely to be centralized.

Size of the parent and subsidiary

According to Baliga and Jaeger (1984), as well as Snell (1992), the size of the subsidiary is linked with the design of the control mechanisms. However, two competing mechanisms could be at play here. On the one hand, the increased size of a subsidiary could mean that it can build up its own resources and become independent from the HQ; conversely, a very large subsidiary may be particularly important to the HQ as a profit center, and may require more control than usual. And the only way to do this may be by a variety of formal, centralized or bureaucratic controls (see section below on details of these types of controls), ultimately leading to more overall controls. We, therefore, hypothesize that:

H4. Size of subsidiary is positively related to the extent of controls. The larger the size of the parent and subsidiary, the greater the degree of control exercised by the parent.

Methods

Data and measurement

A survey research design involving the use of a questionnaire as the primary data source was adopted. The survey instrument went through several iterations and was fine-tuned after a pilot study. In the main survey, data were collected from MNEs' subsidiaries in three major cities, namely Riyadh, Jeddah and Jubail. The subsidiaries studied were from the *Directory of Foreign Companies* in Saudi Arabia, published by the Saudi Arabia Investment Authority. Additional sources, such as business associations and government agencies, were also contacted to cross check and update the information in some instances. A total of 350 subsidiaries were initially randomly selected and contacted in person, or via telephone and e-mail, of which 147 agreed to take part in the study and responded to the survey (42 per cent response rate). Preliminary and statistical tests (see below section on analysis) show that the data collected satisfy reliability criterion, and that factor loadings, average variances extracted (AVE) and reliability tests provide sufficient confirmation of the convergent validity (CV) for the variables.

The survey instrument had five sections: section one was directed toward obtaining information on control variables, including the size of the parent and subsidiary, its age, sector and the nationality of the manager. Subsequent sections were directed toward eliciting information on the role of expatriates, the HQ–subsidiary relationship, performance, structure and knowledge flows. Control mechanisms were measured with the help of 11 Likert-scale questions (5 being the highest) on the four categories and formed the basis for dependent variables (see below for details). Some replies to survey questionnaires were delayed. Follow-up calls to the subsidiaries revealed that the delay occurred as a number of managers were being consulted before the questionnaire was

finally filled in. Subsequent checks on the data revealed that data are consistent and reliable.

Dependent variables

Four categories of dependent variables signifying level and variety of controls were created (see Table I). “Centralized controls”, which includes replies to the following areas of interest:

- the level of autonomy in the subsidiary to decide its own strategies;
- the degree of surveillance that headquarters’ managers execute toward this subsidiary; and
- the degree to which the HQ uses expatriates to directly control the subsidiary’s operations.

“Formal controls”, which includes replies to the following areas of interest: the degree of standardization that the headquarters requires from the subsidiary and the kind of rules and procedures that the HQ exerts toward the subsidiary. “Output controls”, which includes replies to the following areas of interest: the degree of output control that the headquarters exerts toward the subsidiary and the type of planning/goal setting/budgeting that the headquarters uses toward the subsidiary. And finally “informal controls”, which includes replies to the following areas of interest: the degree of participation by the subsidiary’s executives in committees/taskforces/project groups, to what extent do the executives in the subsidiary share the company’s values, the degree of participation of the subsidiary’s executives in training programs and the level of informal communication between the subsidiary and the headquarters and other subsidiaries. All variables are measured on a five-point Likert scale, ranging 1-5, with 5 signifying the highest level of control.

Independent variables

The independent variables consist of the size, firm and country-related factors. This study employs 25 independent variables: 1 is the (log of) subsidiary employment; 2 is

Table I.
Convergent validity
(standardized factor
loadings, average
variance extracted
and reliability
results)

Items	Centralized controls (CC)	Formal controls (FC)	Output controls (OC)	Informal controls (IC)
CC 2	0.870			
CC 3	0.800			
CC 1	0.748			
FC1		0.891		
FC2		0.881		
OC1			0.900	
OC2			0.887	
IC1				0.846
IC3				0.805
IC4				0.578
IC2				0.550
AVE	0.52	0.66	0.76	0.50
Reliability (Cronbach’s α)	0.73	0.73	0.76	0.66

(log of) employees worldwide; 3 is the (log of) number of expatriates in subsidiary; 4 is the age of the subsidiary; 5-9 are industry dummies (petroleum, chemicals, electronics and electrical, motor vehicles and food and beverages); 10-17 comprise group parent nationality dummies: 10, Germany and Switzerland; 11, the Netherlands (continental European capitalist economies); 12, Australia and Canada (softer liberal market economies); 13, Denmark and Sweden (social democracies); 14 Japan (CME); 15 Italy; 16 South Korea; 17 China, Lebanon, Kuwait, Egypt and Jordan (Middle Eastern emerging economies) – the omitted dummy (group 0) is the USA and the UK (which were correlated); variables 18 and 19 represent the nationality of the subsidiary (Saudi or third country); 20 and 21 represent the ownership status of the subsidiary (majority-owned or joint venture); 22-25 represent the subsidiary function – (22, marketing and sales; 23, manufacturing; 24, assembly; 25, services); 26-29 represent the four types of control exercised (26, “centralized” controls; 27, “formal” controls; 28, “Output” controls; 29, “informal” controls).

Statistical procedure

The statistical analysis is carried out with the help of factor analysis, mean, sd, zero-order correlations and ordinal regression analysis. The ordinal regression used to analyze part of the data may be written in the form as follows if the logit link is applied: $f[g_j(X)] = \log \{g_j(X)/[1-g_j(X)]\} = \log \{P(Y \leq y_j | X)/[P(Y > y_j | X)]\} = a_j + \beta X$, $j = 1, 2, \dots, k-1$ and $g_j(x) = e^{(a_j + \beta X)} / [1 + e^{(a_j + \beta X)}]$, where j indexes the cutoff points for all categories (k) of the outcome variable. If multiple explanatory variables are applied to the ordinal regression model, BX is replaced by the linear combination of $\beta_1 X_1 + \beta_2 X_2 + \dots + \beta_p X_p$. The function $f[g_j(X)]$ is referred to as the link function that connects the systematic components (i.e. $a_j + \beta X$) of the linear model. The alpha a_j represents a separate intercept or threshold for each cumulative probability. The threshold (a_j) and the regression coefficient (β) are unknown parameters to be estimated through means of the maximum likelihood method (Chen and Hughes, 2004).

Results

Reliability and validity of variables

Before the statistical work began, the data were subjected to CV which can be tested in the form of three indicators: factor loadings, AVE and reliability of the variables and their measuring items (Hair *et al.*, 2010). The results in our case show that the factor loadings of each variable indicator are significant (in comparison to sample size), ranging from 0.55 to 0.90, demonstrating a strong association between variables and their factors. Further, the results indicate that AVE values are higher than the required threshold value of 0.50, demonstrating adequate convergence of the variables. Finally, the results of the Cronbach's alpha test indicate that the scales satisfy the reliability criterion, with values ranging from 0.66 to 0.76. Taken together, as recorded in [Table I](#), the results of factor loadings, AVE and reliability tests provide sufficient confirmation of the CV for the variables listed in the [Table I](#) below.

Descriptive results

[Table II](#) reports the mean, standard deviations and zero-order correlations of variables. Selected highlights of the table are as follows. Centralized controls are positively associated with the overall size of the firm, motor vehicles industry and majority subsidiary holdings, but negatively associated with subsidiaries that are performing

Table II.
Basic statistics and
correlations

Variables	M	SD	1	2	3	4	5	6	7	8	9	10
1	7.21	1.04	1									
2	10.17	1.03	0.83***	1								
3	4.33	1.33	0.83***	0.24**	1							
4	0.41	0.49	-0.34***	0.24**	-0.25**	1						
5	0.20	0.40	0.06	0.26**	0.06	-0.05	1					
6	0.56	0.50	-0.03	-0.16	-0.02	0.06	-0.39**	1				
7	0.37	0.48	-0.22***	-0.23**	-0.21*	-0.07	-0.39**	0.31**	1			
8	0.37	0.49	-0.05	-0.12	-0.02	0.12	0.45**	-0.33**	-0.59**	1		
9	0.06	0.24	0.04	0.28**	0.06	-0.16	-0.13	0.23**	-0.19*	-0.19*	1	
10	0.10	0.30	0.11	0.08	0.12	0.13	-0.11	-0.06	-0.26**	-0.26**	-0.09	1
11	0.34	0.48	0.16	0.32**	0.15	-0.05	0.35**	-0.14	-0.28**	0.36**	-0.18*	0.23**
12	0.27	0.44	-0.28***	-0.50***	-0.25**	-0.04	-0.30**	0.13	0.50**	-0.18*	-0.15	-0.20*
13	0.16	0.37	-0.22***	0.04	-0.19*	0.04	-0.22**	0.09	0.19*	0.04	-0.11	-0.15
14	0.35	0.48	0.18*	0.07	0.11	-0.27**	0.16*	-0.09	-0.14	0.38**	0.11	-0.24**
15	0.16	0.36	0.04	-0.02	0.08	0.13	0.06	-0.07	-0.13	-0.14	0.20*	0.16*
16	0.06	0.24	-0.12	-0.03	-0.15	-0.10	-0.13	0.05	0.33**	-0.19*	-0.06	-0.09
17	0.15	0.36	-0.14	-0.14	-0.10	0.23**	0.12	-0.12	-0.16	-0.01	-0.10	0.17*
18	0.14	0.34	-0.09	0.40**	-0.08	0.15	-0.01	-0.08	-0.09	-0.31**	-0.10	0.52**
19	0.13	0.34	0.00	-0.16	0.02	-0.20*	-0.19*	0.14	0.25**	-0.29**	0.32**	-0.06
20	0.08	0.27	-0.14	-0.35**	-0.12	0.01	-0.15	0.16*	0.18*	-0.02	-0.07	-0.10
21	0.07	0.25	-0.13	-0.14	-0.07	0.21*	-0.14	0.02	-0.21*	0.34**	-0.07	-0.09
22	0.04	0.20	0.18*	0.04	0.18*	0.24**	-0.10	0.04	-0.09	0.19*	-0.05	-0.07
23	0.05	0.23	0.22***	0.17*	0.21*	-0.02	-0.12	0.21**	-0.18*	-0.18*	0.44**	-0.08
24	0.07	0.25	-0.13	-0.06	-0.10	0.04	0.19*	-0.09	0.07	0.07	-0.06	-0.09
25	0.16	0.36	-0.26***	-0.35**	-0.18*	0.36**	-0.03	0.08	0.09	-0.02	-0.11	0.10
26	3.22	0.99	0.04	0.43**	0.02	-0.14	0.30**	-0.01	-0.21**	0.08	0.16*	-0.15
27	4.11	0.74	-0.06	-0.17*	-0.02	0.11	0.14	-0.26**	-0.14	0.12	-0.03	0.10
28	4.19	0.69	0.17*	0.19*	0.17*	0.12	0.30**	-0.21*	-0.09	0.08	-0.36**	0.23**
29	4.02	0.65	0.21***	0.18*	0.17*	0.01	0.35**	-0.32**	-0.44**	0.17*	-0.07	0.25**

(continued)

Variables	M	SD	11	12	13	14	15	16	17	18	19	20
1	7.21	1.04										
2	10.17	1.03										
3	4.33	1.33										
4	0.41	0.49										
5	0.20	0.40										
6	0.56	0.50										
7	0.37	0.48										
8	0.37	0.49										
9	0.06	0.24										
10	0.10	0.30										
11	0.34	0.48										
12	0.27	0.44		1								
13	0.16	0.37		-0.17*	1							
14	0.35	0.48		-0.32**	-0.19*	1						
15	0.16	0.36		-0.11	-0.18*	-0.31**	1					
16	0.06	0.24		-0.18*	-0.31**	-0.18*	-0.11	1				
17	0.15	0.36		-0.25**	-0.18*	-0.31**	-0.18*	-0.10	1			
18	0.14	0.34		-0.23**	0.09	-0.28**	0.10	-0.10	-0.10	1		
19	0.13	0.34		0.18*	-0.17*	0.27**	0.11	-0.09	-0.11	-0.11	1	
20	0.08	0.27		0.49**	0.13	-0.01	-0.13	0.34**	-0.12	-0.11	-0.11	1
21	0.07	0.25		-0.16*	0.24**	0.09	-0.12	-0.07	-0.11	-0.10	-0.10	-0.08
22	0.04	0.20		-0.12	-0.09	0.21*	-0.08	-0.05	0.01	-0.08	-0.08	-0.06
23	0.05	0.23		-0.17*	-0.10	-0.17*	0.55**	-0.06	-0.10	-0.09	-0.09	-0.07
24	0.07	0.25		-0.16*	0.25**	-0.20*	0.25**	-0.07	-0.11	-0.11	-0.10	-0.08
25	0.16	0.36		0.12	-0.19*	-0.31**	-0.18*	-0.11	0.60**	-0.17*	-0.16*	-0.13
26	3.22	0.99		-0.10	0.05	0.08	-0.23**	0.19*	-0.08	0.14	-0.18*	0.17*
27	4.11	0.74		-0.17*	0.04	-0.01	0.14	-0.21*	0.15	-0.05	0.11	0.09
28	4.19	0.69		-0.13	-0.14	-0.02	0.15	0.01	0.09	0.10	-0.16*	0.06
29	4.02	0.65		-0.03	-0.14	-0.17*	0.26**	-0.12	0.09	0.14	-0.03	-0.16*

(continued)

Table II.

Variables	M	SD	21	22	23	24	25	26	27	28	29
1	7.21	1.04									
2	10.17	1.03									
3	4.33	1.33									
4	0.41	0.49									
5	0.20	0.40									
6	0.56	0.50									
7	0.37	0.48									
8	0.37	0.49									
9	0.06	0.24									
10	0.10	0.30									
11	0.34	0.48									
12	0.27	0.44									
13	0.16	0.37									
14	0.35	0.48									
15	0.16	0.36									
16	0.06	0.24									
17	0.15	0.36									
18	0.14	0.34									
19	0.13	0.34									
20	0.08	0.27									
21	0.07	0.25	1								
22	0.04	0.20	-0.05	1							
23	0.05	0.23	-0.06	-0.04	1						
24	0.07	0.25	-0.07	-0.05	-0.06	1					
25	0.16	0.36	-0.12	-0.09	-0.10	-0.12	1				
26	3.22	0.99	0.08	-0.19*	0.18*	0.07	-0.26**	1			
27	4.11	0.74	0.24**	0.13	-0.12	0.14	-0.09	0.11	1		
28	4.19	0.69	0.12	0.22**	-0.07	0.22**	-0.13	0.33**	0.59**	1	
29	4.02	0.65	0.09	-0.18*	0.08	0.14	-0.08	0.33**	0.45**	0.49**	1

Notes: **Correlation is significant at the 0.01 level (two-tailed); *Correlation is significant at the 0.05 level (two-tailed); 1 = Log subsidiary employment; 2 = log employees worldwide; 3 = log expatriates in subsidiary; 4 = age of subsidiary; 5-9 are respective industries: petroleum, chemicals, electronics and electrical, motor vehicles, food and beverages; 10-17 are nationality of the parent; 10 = Germany, Switzerland, the Netherlands; 11 = Australia, Canada; 12 = Denmark, Sweden; 13 = Japan; 14 = Italy; 15 = South Korea; 16 = China; 17 = Lebanon, Kuwait, Egypt and Jordan; 18, 19 represent the nationality of the HR director; 20-21 represent subsidiary type-majority owned or joint venture; 22-25 represent subsidiary function—22 = marketing and sales; 23 = manufacturing; 24 = assembly; 25 = services. No. 26-29 represent the type of control exercised

marketing and sales functions. Formalized controls do not seem to be favorable and, notably, are negatively associated with the overall size of the firm and motor vehicles industry and with joint venture forms of business operations. Output controls are positively associated with CME parents and with majority-owned services firms where the nationality of the manager is Saudi Arabian. Finally, informal controls are positively associated with services industry, size of the firm and number of expats in the subsidiary, chemicals industry and in firms where managers are from a third country. Informal controls are negatively associated with the joint venture form of operations.

Multivariate analysis of results

Table III provides the results of ordinal multivariate regression analysis on 4 control variables and 25 independent variables as described above. Table III provides the results of the hypotheses, as well as additional results discussed separately.

The first hypothesis states that formal control in MNEs from highly financialized LMEs will be higher than in those MNEs from other capitalist archetypes. Table III reports the results of the regression analysis on eight groups of country dummies, four of which are domiciled in Europe: Group 10 (Germany, Switzerland, the Netherlands), Group 11 (Australia, Canada), Group 12 (Denmark, Sweden) and Group 13 (Italy). The USA and the UK, the two highly financialized countries, were used as control group. The results for this hypothesis are revealing. The “centralized” controls coefficient for all of these groups of countries is significant but negative. For the “formal” method of controls, the results are negative and significant only in the case of Italian parents. For groups of countries 10, 11 and 12, the coefficient, though positive, is not significant. With regard to “output” controls, the coefficient is significant but negative in the case of group 11 and 12 countries; it is positive but not significant in the case of group 10 countries. Finally, for “informal” means of control, the coefficient is significant but negative in the case of all the groups except Italy, in whose case the coefficient is positive but not significant. Extending the results for Asian capitalist economies, we notice that Japanese parents have a significantly negative attitude to all forms of controls except control by “formal” mechanisms, the coefficient for which is not only positive but highly significant, contrary to what is suggested by earlier work (Lincoln *et al.*, 1986). The results for South Korean parents are similar to those of Japanese parents except that the coefficient for control by “formal” means, though positive, is not significant. Chinese parents display a negative approach to all forms of control mechanisms. Middle Eastern market economy parent firms rely heavily on “bureaucratic” means of controls, the coefficient for which is not only positive but highly significant. The latter might reflect an Ottoman bureaucratic tradition, which continues to exert a long-term influence regarding formal regulation and organizational procedures (Findley, 1980; Heper and Berkman, 2009). Overall, the results support the test for the first hypothesis. Compared to the control group of the highly financialized group of countries (the USA and the UK), the results for the rest of LME group of countries display a negative approach to controlling their subsidiaries by the four methods of controls analyzed. For *H1*, therefore, we get mixed results.

H2 states that MNE subsidiaries employing large numbers of domestic managerial staff are more likely to be centralized. Results show that this seems to be the case, as out of four types of controls, the coefficients of two genres of controls – “formal” and

Independent variables	Dependent variables			
	Centralized controls-PC Coefficient	Formal controls FC Coefficient	Output controls-OC Coefficient	Informal controls-IC Coefficient
<i>Subsidiary size, expats and age</i>				
1. Employees subsidiary	0.488	0.456	1.319**	1.314***
2. Employees worldwide	2.205***	2.009***	6.273***	4.905***
3. Expatriate numbers	-0.097	-0.047	-0.206	-0.423
4. Age	0.002	0.864	0.389	0.746
<i>Industry</i>				
5. Petroleum	1.586	2.082	1.636*	8.953***
6. Chemicals	-0.934	-3.004*	1.597**	2.501*
7. Electronics and electrical	11.563***	-4.304**	1.538**	1.048
8. Motor vehicles	-0.4.148**	13.751***	1.775**	8.934***
9. Food and beverages	-1.609	-18.169***	1.891***	-8.658***
<i>Parent nationality</i>				
10. Parent_GSN	-9.875***	0.969	1.098	-2.919**
11. Parent_ALCA	-6.937***	1.515	-3.768*	-2.207**
12. Parent_DNSW	-6.201***	-0.235	-11.067***	-2.084**
14. Parent_IT	1.963*	16.325***	-21.916***	-8.421***
13. Parent_JP	-10.689***	-11.670***	-10.787***	0.928
15. Parent_SK	-19.680***	1.605	-8.146***	-5.072**
16. Parent_CH	-15.073***	-7.754***	-17.624***	-9.703***
17. Parent_MME	-2.166	9.209***	-1.484	2.198
<i>Manager nationality</i>				
18. Saudi nationals	-1.957**	2.073*	-2.702**	5.180***
19. Third-country nationals	-7.746***	-16.240***	-12.467**	-10.589***
<i>Subsidiary type</i>				
20. Majority owned	-6.111***	-6.793***	-4.476***	-1.478**
21. Joint venture	-0.540	-0.143	-0.399	-0.308
<i>Subsidiary function</i>				
22. Marketing and sales	4.964***	-2.407	-2.962*	-2.393
23. Manufacturing	1.867	1.691	0.462	-8.725***
24. Assembly	1.832	-3.602**	12.952***	3.219**
25. Services	3.057**	-7.538**	-9.289***	-7.797***
<i>Model fitting Statistic</i>				
-2 Log likelihood	429.743	227.137	205.580	380.605
χ^2 (21 dof)	280.310 (0.000)	256.071 (0.000)	266.055 (0.000)	258.594 (0.000)
<i>R² Cox and Snell</i>				
	0.85	0.82	0.83	0.82

Notes: *** $p < 0.001$; ** $p < 0.05$; * $p < 0.10$; 1 = log subsidiary employment; 2 = log employees worldwide; 3 = log expatriates in subsidiary; 4 = age of subsidiary; 5-9 are respective industries: petroleum, chemicals, electronics and electrical, motor vehicles, food and beverages; 10-17 are nationality of the parent: 10 = Germany, Switzerland, the Netherlands; 11 = Australia, Canada; 12 = Denmark, Sweden; 13 = Japan; 14 = Italy; 15 = South Korea; 16 = China; 17 = Lebanon, Kuwait, Egypt and Jordan; 18,19 represent the nationality of the HR director; 20-21 represent subsidiary type-majority owned or joint venture; 22-25 represent subsidiary function--22 = marketing and sales; 23 = manufacturing; 24 = assembly; 25 = services; no. 26-29 represent the type of control exercised

Table III.
Regression results on control mechanisms

“informal” turn out to be positive and significant. This is a highly illuminating result, as it signifies several essential points. First, a Saudi manager entrenched in local customs and values is best placed to deal with his/her subordinate staff when it comes to interfacing formally. At the same time, there will be many demands stemming from the operation of the extended informal clan and client list networks of support, and to take account of local restrictions on working hours (e.g. during hours of prayer). An instance would be meeting certain deadlines, which might require the use of overtime or working on holidays. A manager embedded in the local culture and speaking local dialects is ideally placed to deal with such situations and get the job done. It should also be noted here that in all likelihood most non-managerial staff employed in subsidiaries will also be locally sourced, in which case junior Saudi managers are best placed to deal with them. The results thus largely support the second hypothesis.

H3 states that “MNEs employing high numbers of third country expatriates are less likely to be centralized”. We indeed find that the presence of third-country managers has a negative influence on all types of controls; in other words, their presence leads to a reduction in the quantum of control exercised by the HQ over its subsidiary. Given that expatriate working and living in Saudi Arabia has a general reputation for being extremely challenging (Bradley, 2015), MNEs may battle to entice suitably qualified Western nationals to take on assignments. In turn, this means that MNEs may make extensive usage of skilled managers from developing nations, who are more likely to be enticed by favorable pay rates (c.f. Mellahi and Wood, 2001). However, developing country expatriates face particular challenges, which can range from petty discrimination to a greater likelihood of arbitrary expulsion (Bradley, 2015; Mellahi and Wood, 2001; c.f. Buhaini *et al.*, 1996), and are likely to be particularly vulnerable to Saudization drives. Hence, while it may facilitate the decentralization of decision making for the reasons outlined above, it also brings with it real risks. The results thus prove the third hypothesis.

H4 states that the size of the subsidiary will positively relate to the extent of controls. The larger the size of the parent and subsidiary, the greater the degree of control exercised by the parent. Table III reports the results regarding the numbers employed in the subsidiary and its impact on four categories of controls. The results indicate that this seems to be the case, as the coefficient is not only positive on account of all four control types but is also significant in the case of control by “output” and “informal” means. The results also show that the size of the parent has a significant positive influence too on all four categories of controls; the larger the size of the parent the greater the control exerted on its subsidiaries by all four means. The results thus support the fourth hypothesis.

Additional results

In addition to the results related to the testing of our hypotheses, Table III also reports further results in terms of “ownership”, “age (number of years operating in Saudi)” and sector. The results show that majority-owned subsidiaries negatively influence all types of control; it seems that majority-owned subsidiaries have more delegated authority than is the case with other forms of ownership. For joint ventures, none of the control mechanisms from HQ are shown to be significant. This could be owing to the simple fact that in joint operations, duties and responsibilities may be equally shared. The age of the subsidiary (i.e. whether it has been established relatively recently or further in the past) does not seem to have any bearing on control mechanisms. Subsidiaries engaged in

marketing and sales positively influence “centralized” controls; the manufacturing sector views negatively “informal” means of control. In assembly line businesses, reliance seems to be more on controls by way of “output” and “informal” means. Assembly line businesses also negatively view control by “centralized” methods. This makes sense as output, i.e. units assembled per worker or per shift, are easily counted, especially when the compensation is linked to output. Finally, in the service industry, centralized controls predominate. This is explainable by the fact that policy and directives in the services sector are largely centrally formulated and also monitored by HQ.

Discussion

This study explores the relationship between country of origin, indigenization and control mechanisms exerted by MNEs over their subsidiaries. While some of the findings confirm a wide base of existing knowledge, *inter alia*, encompassing the reliance on more formal methods of control in larger firms, we also find evidence of a proclivity of MNEs from highly financialized LMEs for greater control, possibly to more directly appease the demands of activist shareholders. In contrast, the existing literature suggests that the latter is the case for US MNEs, the study confirms that this is also so for British ones, highlighting the common ground between the two highly financialized LMEs. This is very different behavior to those of MNEs from other LMEs, which have more in common with their CME peers. And, while there are strong government pressures to employ and advance Saudi nationals, existing research highlights the slow progress this may have made (Sadi and Al-Buraey, 2009). What this study adds is that when firms do employ significant numbers of Saudi nationals, they appear not to be trusted: in such instances, the head office exerts tighter and more formal control. With regard to size, it seems that larger the organization, the higher the degree of control, probably because more is at stake. More specifically, output controls become progressively important as firms increase in size. At the same time, the level of autonomy and informal communication between the HQ and fellow subsidiaries decreases; this reflects the extent to which larger firms rely on more formalized and bureaucratic mechanisms of control, which, at the same time, allow for economies of scale (Brewster *et al.*, 2007).

Firms can also exercise controls by means of non-measurable cultural bindings, commonly referred to as control by informal and social means (Ferner, 1997). This may be attained by locating a sizeable number of managers from home within the subsidiary. However, we find that it is the usage of expatriates *per se*, rather than simply parent country nationals, that leads to greater autonomy. In other words, this difference cannot be explained by the usage of social or informal control mechanisms, as the expatriate managers did not originate from the same nation or cultural background. What appears to be the case is that firms simply trust host country nationals less. There are two possible explanations for this. The first is that, subsidiaries may primarily hire locals to meet Saudization requirements. Chronic shortfalls in technical training and a bias of tertiary education toward fundamentalist religious subjects means that there is a shortage of suitably qualified locals, with firms responding through resorting to “window dressing”, while making sure that important decisions are left to head office. A reliance on formal control mechanisms makes it easier to manage the aspirations of Saudi managers, creates an impression of equity between domestic and expatriate

managers (as all are subject to the same rules and procedures), and reduces the chance of accusations of favoritism or discrimination. It may also reflect deeply embedded cultural stereotypes – and prejudices – widely held by outsiders in dealing with the Middle East, a reflection of specific colonial legacies and strategies developed toward the exploitation of the region's natural resources (see Said, 2003); this may make for a mutually reinforcing cycle of mistrust, necessitating, but also worsened by, low levels of local autonomy.

Taggart and Hood (1999) suggest that higher autonomy in MNE subsidiaries makes for greater innovative capabilities. However, our study reveals that in the manufacturing and high-technology sectors, direct control is greater. The former might simply reflect the present state of Saudi manufacturing, geared toward standardized goods, manufactured through the usage of Taylorist methods. However, the latter might, again, indicate a lack of trust, and the desire to protect proprietary knowledge (Buckley and Casson, 1976; Richards, 2000). We also find that controls are significantly less in majority-owned subsidiaries. MNEs which have been operating longer in the country are less likely to make usage of direct controls, probably indicative of a greater experience in navigating local waters, the operation of informal networks and a more nuanced awareness of the signifiers of trustworthiness in local partners and staff.

Research contributions, limitations and extensions

The relationship between HQ and subsidiaries, and the degree of autonomy accorded to the latter, is a very mature area of research. However, this is one of few studies of this nature conducted for the region of Middle East – and the only one we are aware of for Saudi Arabia – and sheds new light on the impact of contextual circumstances on how closely firms monitor their subsidiaries. Our empirical work not only replicates earlier studies, retesting propositions encountered in the existing literature, but also sheds new light on the challenges of doing business in the Gulf region, and the consequences of the large-scale usage of expatriates.

The methodology adopted can be extended to other host countries. A useful extension would be to link different control mechanisms with the perceived and actual financial performance of subsidiaries. They can also be linked with the objectives and strategies of subsidiaries *vis-à-vis* HQ. In a multi-country study of this nature, it can be researched if inter-country differences exist between the control mechanisms of subsidiaries of the same parent operating in different host countries. Such a study would also account for the limitations of one-country studies, and shed further light on what really defines individual national settings.

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