

**THE ROLE OF AN INTERMEDIATE SUBSIDIARY IN THE
MANAGEMENT CONTROL SYSTEM**

SINIKKA MOILANEN

University of Oulu, Department of Accounting and Finance

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Contact Address:

Sinikka Moilanen

Department of Accounting and Finance, University of Oulu

P.O. Box 4600, FI-90014 University of Oulu, Finland

Phone: +358 8 553 7784

Fax: +358 8 553 2906

Email: sinikka.moilanen@oulu.fi

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Abstract

While accounting enables control at a distance according to the parent corporation's disembodied requirements, these requirements can be reembedded into the local context in different ways. This study uses case study methodology to examine how an intermediate subsidiary can stabilize the management control system between itself and its subsidiaries in the Baltic countries and Russia. The role of the intermediate is explored in a context where the Western owner pushes for control through financial and accounting measures. The study shows how the intermediate acts as a buffer filtering the strict requirements from its parent, as it meddles with both disembodiment and reembedding mechanisms. The intermediate translates the information coming from its subsidiaries into the parent's format and communicates the parent's requirements to the subsidiaries through its own social structures. Even though the dictates of the parent are not decoupled from the local day-to-day work, the intermediate dampens the parent's control system by interfering in the reembedding of this system with its facework commitments and concrete operational cooperation. This happens when the intermediate rationalizes its role and existence, claiming that the abstract system of the parent needs to be supplemented with local controls (abstract systems) and more concrete cooperation for developing operations so that the total system would be trustworthy.

Keywords: Management Control, Transitional economies, Subsidiary's role, disembodiment, reembedding

1 Introduction

Accounting and management research have extensively explored different strategic roles of subsidiaries in multinational corporations (MNCs) and their connections to management control systems (MCSs) (e.g. Chung et al., 2000; Gupta and Govindarajan, 1991; 2000; Taggart, 1997). It is widely acknowledged that subsidiaries with different roles require different controls (Baliga and Jaeger, 1984; Birkinshaw and Morrison, 1995; Nobel and Birkinshaw, 1998) and that large corporations often rely mainly on financial control (e.g. Chenhall, 2003). Accounting indeed enables the control in MNCs, as it allows control and action at a (geographical) distance according to the parent's logic (cf. Kirk and Mouritsen, 1996; Robson, 1992). While current literature extensively studies management control in MNCs from the point of view of both the MNCs and subsidiaries (e.g. Brownell, 1987; Kirk and Mouritsen, 1996; Quattrone and Hopper, 2005), little exploration is focused on the MNCs which are expanding their operations to transitional economies where different business traditions prevail. Yet, a growing number of MNCs is exploiting the interesting possibilities provided by the enormous market potential of e.g. the former Soviet Union. As accounting and management traditions in the planned economies significantly differed from those of Western countries (see Enthoven et al., 1998; Sokolov and Kovalev, 1996; Taylor and Osipenkova, 2003), it is highly questionable if merely financial results control by the MNC's parent can be relied on. Southworth (1994) and Smirnova et al. (1996) have also claimed that help is needed in the former Soviet Union for developing accounting and it has been shown that Western firms can provide this help for their partners in transitional countries (e.g. Firth, 1996).

This study explores how and explains why an intermediate subsidiary maintains and stabilizes the control between itself and its subsidiaries in Russia and the Baltic countries, even though the Western parent company pushes for control through the budgeting system and accounting figures. Reporting to the parent from the Baltic subsidiaries goes through the intermediate, but the parent company makes effort to develop neither the operations of the case firm nor those of its Baltic subsidiaries. The interpretation draws on Giddens' (1990) terminology of disembedding and reembedding. The analysis shows how the intermediate firm interferes with disembedding and reembedding in the parent's control and therefore filters and dampens the dictates of parent's social system stabilizing the perceived control¹. The results show that the stability is rationalized by the idea that pure financial control is probably not the most efficient way to operate with subsidiaries in the former Soviet Union, because the number-based expert system needs to be supplemented with other controls, which take into account the requirements for control arising from the local circumstances.

This study extends the current literature in three main respects. First, it adds on the literature on stability of management accounting and control (e.g. Burns and Scapens, 2000; Granlund, 2001; Siti-Nabiha and Scapens, 2005) showing how and why the intermediate subsidiary can maintain local management control even though the new requirements from the parent company are not decoupled from the local day-to-day work. Second, the discussion is linked to business operations in specific transitional economies, where pure financial control would unlikely be effective and where the role of an intermediate firm can be important, because of the different

¹ Andersson and Forsgren (1996) define perceived control as the extent to which the subsidiary considers headquarters to exert influence on its behavior.

business traditions (cf. Taylor and Osipenkova, 2003). Third, this study adds to the literature on the connections between the roles of subsidiaries and the control systems (e.g. Chung et al., 2000; Gupta and Govindarajan, 1991; 2000; Taggart, 1997).

The rest of the paper is organized as follows: section 2 presents conceptual and theoretical guidelines; section 3 covers the research design; the case firm's control and its structural context are introduced and analyzed in section 4; section 5 discusses the disembedding and reembedding mechanisms in the control system of the case firm; section 6 concludes the paper.

2 Conceptual and Theoretical Guidelines

This study uses Giddens' (1990) sociology of modernity to explore the role of an intermediate subsidiary in the MCS where the control is based on disembedded accounting information. The analysis explores and explains the intermediate's role in disembedding and reembedding when the parent's requirements are implemented in the local contexts.

2.1 Disembedding: Accounting and the control over local operations

Giddens (1984, 1990) claims that social practices are ordered across space and time. However, space and time are separated in modernity. This happens with the help of symbolic tokens (specifically money) and expert systems (Giddens, 1990, p. 22). Giddens (1990, p. 27) defines expert systems as "*systems of technical accomplishment or professional expertise that organize large areas of the material and social environments in which we live today.*" Jones and Dugdale (2001)

acknowledge that accounting is a special disembedding mechanism as it is an expert system, which uses money as a symbolic token, i.e. represents other forms of data in terms of money. Accountants meddle with time, for example when discounting cash flows, but they also create spaces around accounting entities that might not have any physical counterpart (e.g. Carmona et al., 2002).

The separation of space and time occurs in the process of disembedding (Giddens, 1990; Jones and Dugdale 2001). The process of disembedding consists of reflexive monitoring of social practices structured around attribution of meaning (signification), value (legitimation) and power (domination) (Giddens, 1984; 1990; Jones and Dugdale, 2002). For example, accounting disembeds (lifts up) the local social relations to a global level, as it is an interpretative scheme that communicates the parent's requirements downwards in the organizational hierarchy (see Macintosh and Scapens, 1990). Consequently, accounting is important for control, especially in MNCs, as it allows control and action at a distance. Accounting is an inscription which can make local issues a global matter with a common language (see Latour, 1987; Robson, 1992). Therefore, accounting makes performance visible and, controllable. In this way the accountability system can be used as a means for the parent to dominate, which means monitoring and intervening in subsidiaries' affairs rather than mapping the subsidiaries according to their own social structures (cf. Kirk and Mouritsen, 1996). Accounting thus operates and meddles with social relations more broadly and deeply than it appears at first sight and it is a distinctive way of thinking that has gained a position of an indicator in an individual's adoption of an appropriate business-oriented mindset (see Jones and Dugdale, 2001; Kirk and Mouritsen, 1996).

The dimensions of structures (signification, legitimation and domination) are inextricably linked and only analytically separable (Giddens, 1984, p. 28; Macintosh and Scapens, 1990). Signification structure comprises of e.g. the concepts which are drawn upon to make sense of organizational activities. Accounting concepts, such as profit, have signification also outside the interpretative scheme (of a particular accounting system), but a management accounting/control system gives them a specific time-space location relating them to the local context. Legitimation structure is mediated through norms, moral codes and possible sanctions. For example, the use of accounting legitimates accountability and communicates values and ideals. Legitimation structure makes visible what is approved and what is seen as important (and *vice versa*). Domination structure deals with power in the organization. Power can be seen narrowly as pure domination or in the broad sense as the ability to get things done (Giddens, 1984; Macintosh and Scapens, 1990). The power derives from the asymmetric distribution of resources. Accounting is also a key element in the process of accountability in organizations and thus mediates the domination structure in relations of power. Power is exercised through allocative (command over objects, goods and materials) and authoritative (capabilities to organize and coordinate the activities of social actors) resources. However, also subordinates (subsidiaries) can exercise power in social relations, as they can keep some information from their superiors (parent) and apply parent's directives to the local operations when preparing their reports. (cf. Barrett et al., 2005; Giddens, 1984; Macintosh and Scapens 1990).

2.2 Reembedding: Accounting, trust and acting on the subsidiaries

Disembedding with the help of accounting produces abstracted knowledge of subsidiaries' operations, which is then used in the parent to act back upon local contexts through reembedding in the organizational hierarchy (Giddens, 1990; Jones and Dugdale 2001; Jones et al., 2004). Reembedding is the process by means of which faceless commitments of the disembedding mechanism are sustained or transformed by facework (Giddens, 1990). In the process of reembedding, trust is needed, as the connections are often faceless (Giddens 1990, p. 87). Giddens (1990) divides trust into trust-in-persons and trust-in-systems. Trust-in-persons was the most important form of trust in pre-modern times, whereas trust-in-systems (abstract trust) is needed in modernity. Trust in abstract systems involves faith in the correctness of the principles within the system, not upon good intentions of others (trust-in-persons). However, trust-in-systems must be reembedded into persons, making people access points to the abstract system. Therefore, trust-in-systems and trust-in-persons (expert individuals as the access points of the system) are intertwined. The access points of the system normally try to be trustworthy so that they would represent the system and reinforce faith in the system's capacities through personal performance. For example, the parent company cannot supervise how every accounting figure is attained locally and cannot ignore the risk² that the information does not give an accurate view of the local issues or comes to the parent too late for taking appropriate corrective actions (see Baliga and Jaeger, 1984). Trust is thus needed on the correctness of accounting principles used (trust-in-systems), but also on the local individuals applying to the principles (trust-in-persons).

² According to Giddens (1990) the existence of risk is associated with the need for trust.

This might be especially the case when the business traditions, for example those in the former Soviet Union, differ from the ones of the Western countries. Therefore, the principles within an abstract Western accounting-based control system might not be self-explanatory. The accounting reports in Soviet Union were, for instance, prepared for the authorities for protecting socialist property and fulfilling the plans of the central administration – not for internal management (Enthoven et al., 2001). Accounting was understood as book-keeping and cost accounting was an integral part of financial accounting. Budgeting and planning for the future were tasks taken on by a separate Planning Department, detached from accounting (Enthoven et al., 1998; Sokolov and Kovalev, 1996). Despite the years since the dissolution of the Soviet Union, the transition takes time and traditions prevail. It is not only a matter of accounting, but the overall business tradition in the former Soviet Union differs from the Western model, an example of which is the importance of personal, informal connections in Russia, called *blat* (Hutchings and Michailova, 2004; Ledeneva, 1998; Michailova and Worm, 2003). These informal network structures have traditionally been more reliable than formal structures (Engelhard and Nägele, 2003). Even though *blat* nowadays easily has a negative connotation, as it is associated with bribery, traditional *blat* systems were based on positive mutual friendships and aid (Ledeneva, 1998).

Consequently, accounting may not serve as a common language as business structures and their corresponding understandings of the accounting concepts differ (cf. Evans, 2004). Therefore, it is highly questionable if accounting based control system, the foundation of which is abstract trust, on the subsidiaries in the area of former Soviet Union can be effective. Support for the people applying the principles of the system might be necessary. This possibly highlights the role of an intermediate

subsidiary in filtering the local accounting information according to the disembodied dictates of the parent company and reembedding these accounting-based social relations to the local contexts. The phased conceptualization and explicit acknowledgement of local and global in the theoretical framework make the framework appealing for studying how the intermediate subsidiary intervenes in the both processes of disembedding and reembedding, the intermediate provides access points to the abstract control system. Moreover, as Jones and Dugdale (2001) propose, Giddens' (1990) notion of expert systems is directly applicable to accounting even though it has been employed in accounting studies only rarely (e.g. Barrett et al., 2005; Hyvönen et al., 2006; Jones and Dugdale, 2002) while other notions of Giddens' sociology have been used (e.g. Busco et al., 2006; Granlund, 2001; 2003).

3 Research Design

The present study explores and interprets the role of the case firm as a subsidiary in a multilevel Western MNC. The case firm acts as an intermediate between its parent and its own subsidiaries in the area of the former Soviet Union. The case firm was chosen as a most likely case (Keating, 1995) for finding interesting issues of management control in MNCs operating in the former Soviet Union area. In addition to this, the firm is interesting from the accounting point of view, because of the corporation's extensive reliance on accounting-based controls. The parent company is notably focused on administration and value creation, whereas it is the task of the subsidiaries to pick up the most efficient ways of doing

the actual business. The case firm's MCS and its structural context are introduced in the next section.

The primary data consist of twelve interviews with fourteen people. All interviews except for one more informal conversation were tape-recorded and transcribed. Interviewees consist of people from the Finnish intermediate's head office as well as the local top management and chief accountants in the subsidiaries (details of the interviews are in Appendix). In three interviews, two people were present at the same time, and one interview was conducted through an interpreter (the firm's secretary). In addition, observation notes and issues raised in informal conversations over lunch or coffee were documented with as little delay as possible. The prime triangulation of data was conducted as synchronic and diachronic primary data source triangulation (Pauwels and Matthyssens, 2004), which means interviewing various respondents on the same topic or, alternatively, the same respondents on a particular topic more than once. The data also include examples of internal monthly reports and budgets, internal memos on strategic steering, publications such as annual reports and the history of the case firm, as well as other material provided by the interviewees. These secondary data sources were also used for triangulation, e.g. by confirming what was said about the content of reports.

The interviews were semi-structured so that the themes were initially defined, but the structure and final content took form in the course of every interview. With this method a wider range of issues can be taken into account as they are highlighted in the data and, thus, the interviewees also have the opportunity to bring out important issues from their own point of view (e.g. Shank, 2002). The structure of the first interview covered basic information about the company and its activities in transitional economies. Management control issues – especially the ones which are

important in a multinational firm in the former Soviet Union – and the effects of multinationality on operations as a whole were also addressed. The interesting and firm-specific topics raised in the first interview were then explored in more detail in later interviews

As Atkinson and Shaffir (1998) point out, doing field/case studies means continuously modifying the research topic according to the new data gathered. Therefore, the data collected at any point of time were reviewed and a preliminary analysis was done before every new interview. Even though this might bias the data, a focus for data gathering is necessary as not everything can be observed (Atkinson and Shaffir, 1998). The analysis was conducted in a similar way as in Dent (1991). Various readings and interpretations were constructed as the study progressed. First, the data were analyzed by searching for actors and their actions in order to find the most important aspects for this research. Data were then categorized according to different contexts where control was addressed to be able to compare if the conception of control differed between these contexts. This categorization revealed the different stances taken towards control between the different organizations. Moreover, the guiding concepts and ideas of Giddens' sociology of modernity (1990) began to reveal their usefulness in understanding the stances.

Because of the case study approach, the explanations provided by this study can be based only on specific circumstances in the case (Ryan *et al.*, 1993, pp. 119-120). No absolute truth can therefore be found, as the interpretation is mainly based on interview data and the perceptions of the interviewees. However, theoretical generalizations, which are developed with the help of the utilized theoretical framework, can be used. This is because the pattern model used in explanations does not refute the existence of regularities, but negates only general laws, which would

transcend all social systems. This means that the current study is straddling on the line between objectivism and subjectivism, as theoretically generalizable interpretations with a reference to the theoretical framework and the current literature are searched from the subjectivist reality of the case firm (*cf.* Kakkuri-Knuuttila *et al.*, in press).

4 Finparent's control system and its development

4.1 Finparent and its operations in the area of the former Soviet Union

The case firm is a Finnish company (*Finparent*), with a turnover of 372 million euros in 2006. *Finparent* has five related core businesses within a same industry. The analysis of this study focuses on *Finparent* and its subsidiaries in the area of the former Soviet Union, namely Russia (St. Petersburg), Estonia and Latvia (*Russub*, *Estsub* and *Latsub*, respectively). The turnover of these *Balticsubs*, whose operations are directly steered and controlled by *Balticparent* (a part of *Finparent*) totaled 67 million euros in 2006. Three of *Finparent's* core businesses (in order to preserve anonymity, these businesses are henceforth deferred to as *alpha*, *beta* and *gamma*) are represented in the *Balticsubs*. The subsidiaries have been established in order to conduct the core business in a Finnish way in the neighboring areas. This means that the subsidiaries follow the same broad guidelines as the business in Finland, for example the image of the firm is maintained with the same logos and colors.

The history of *Finparent* started of already in the 1930s. The current form of *Finparent* was, however, established as a merger of two Finnish competitors in 1992. The new firm was then acquired by a Swedish firm in 1993. The first subsidiary in

Estonia was established as a joint venture between *Finparent* and local firms, which provided the possibilities for operations for business *gamma* in 1991. The operations for business *alpha* started in Estonia in 1994, when renovated equipment was imported from Finland in order to start the production. Products for business *beta* are imported to Estonia from Finland. The operations in Latvia also started in the beginning of the 1990s. In Latvia a joint venture for the business *beta* was established with local town's administration, and in 1997 another subsidiary was started up for the business *alpha*. Later on the shares have been acquired from the joint owners in Estonia and Latvia so that the subsidiaries are nowadays fully owned by *Finparent*. The Russian operations of the business *alpha* are located in St. Petersburg. The operations started already in the late 1980s and the current *Russub* was established after the merger in Finland in the early 1990s. In 1994 *Finparent* also established a holding company for managing the *Balticsubs*. Four people (CEO, Business Development Manager, Technical Manager and Controller) are working for *Balticparent*. Moreover, financing of the operations were secured and the risks were reduced with the help of venture capital investors in *Balticparent* in the beginning.

4.2 Controlling from Eurodivision

Finparent is has been a part of different foreign corporations since the early 1990s. In 1999 it was acquired by *Eurodivision* (henceforth refers to all the organizational levels in the parent company of *Finparent*), a corporation operating in 27 countries in Europe and America, with a turnover of almost 19 billion euros (2006). The relevant parts of the total organization structure are presented in Figure 1.

[Insert Figure 1 about here]

Eurodivision focuses on the core businesses of the same industry as *Finparent* and it seeks growth within this industry by acquiring new firms. *Eurodivision* focuses on administration of the businesses and it does not participate in the operational development, but it is up to the local subsidiaries to do the actual business in their own circumstances. Newly acquired firms are analyzed and targets are calculated with the help of financial information. The subsidiaries are then pushed to reach the targets. No common information system is used, but the reporting requirements are communicated in the corporation through predefined spreadsheets.

The information from *Balticsubs* goes to the *Eurodivision* through both *Balticparent* and *Finparent*. Additionally, the official superior of *Balticparent*'s Controller is the CFO of *Finparent* who is the reporting link to *Eurodivision* and controllers there, either directly or indirectly through the *Finparent* CEO. Thus, enquiries and requirements from the *Eurodivision* come first to the *Finparent* CEO or CFO who delegates the issues concerning *Balticparent* to the Controller. *Eurodivision* also needs to fulfill Sarbanes-Oxley (SOX) requirements. *Finparent* falls into the Tier1 category where the documentation requirements are the highest whereas *Balticparent*, carrying less financial weight, belongs to Tier3, where fewer demands are present. Basically, because of SOX the Controller has to perform basic checks in the subsidiaries; and when making entries for consolidation, the entries must be officially approved by her superior, the *Finparent* CFO.

As implied in the current literature, multinational corporations need accounting-based financial control to be able to steer the operations of their subsidiaries (e.g. Emmanuel et al., 1998; Kirk and Mouritsen, 1996; Quattrone and Hopper, 2005). In *Eurodivision* the focus on financial controls is explicit. The

corporation does not interfere with the practical development of the operations in its subsidiaries, but it calculates the financial targets to be reached by them. Thus, budgeting plays a central role in internal reporting and monthly reports, which are in the same format as budgets, and are carefully compared with the budget. People describe budgeting as follows:

“Budget is to them [in *Eurodivision*] as untouchable as the Bible; it is a long and time-consuming process. - - We start calmly and reasonably and then make some changes. For example, from last year, I have 12 different versions of the budget of *Estsub*. - - After we send the first version to *Eurodivision*, they give us [changes] on the fly, really fast.” (Controller)

“Budgeting goes, we begin first in around August, the budget is prepared in autumn and it is ready in October or November. We usually do many rounds, fix it many times. The owner has its own targets. Sometimes we feel that they want us to develop and grow too fast.” (*Estsub* CEO)

The budgeting process begins in the late summer in negotiations with *Balticparent* and the *Balticsubs*. The subsidiaries make their first budget proposals according to the negotiations, after which the actual bargaining starts and different items on the budget are changed recurrently. The sales volume, average sales price and operating profit (EBIT) are the most important items on a budgeted income statement, while capital expenditures and the operative items (receivables and payables) are carefully reviewed from the balance sheet and return on net assets (RONA) is another important key measure. In addition, the budget is based on the 5-year strategy, which is updated annually for *Eurodivision* right after annual financial statements have been finished. This plan is divided into anticipated development on on-going basis (with no expenditure in profit improvement) and the development with possible profit improvement expenditures.

Capital expenditures are similarly divided into replacement, profit improvement as well as social and environmental expenditures. Because of the tight

control over assets and RONA practically every single capital expenditure must be approved by *Eurodivision*. For substitution expenditures, different backup calculations (normal capital budgeting calculations such as payback time and internal rate of return) are needed and when expenditures are for expansion (e.g. acquisitions), a predicted income statement and balance sheet are required with the backup calculations. The central figures (volume, average price, EBIT) are also calculated for the proposals.

Even though *Eurodivision* focuses on a small number of key measures, the operational level is also of concern. The people follow the more detailed operational reports, which the *Balticsubs* prepare for *Finparent*, and where there are variations from the budget (or from the previous year) they demand explanations.

“- - if the first explanation does not satisfy them, of course we first clarify it for ourselves and then the [*Finparent*] CEO is the neck towards the owner in contacts and reporting, we help him to tell things.” (*Finparent* CFO)

“- - an example was that labor costs are increasing in the Baltic countries, because they [in the Baltic countries] have competition against EU-countries, employees get more money elsewhere. - - The percentage growth was so high that there were questions [from *Eurodivision*] and we started to break the numbers in details to see where the figure comes from, or the change.” (Controller)

Thus, even the smallest issues are represented as numbers to *Eurodivision*. The feedback from *Eurodivision* tends to highlight negative variations, whereas increase in sales volume would be left apparently unnoticed. However, the demands and targets for the following year are usually slightly higher. Furthermore, disembedding takes place in multiple hierarchical phases as the requirements as well as most of the reporting and other information between *Eurodivision* and the Controller go through the *Finparent* CFO (and CEO). From the CFO there are still at

least two steps on the way to the local (subsidiary level). Whereas the CFO recognizes:

“- - what is crucial in those big owner corporations for a certain subsidiary, is the contact person. - - And for us that person happens to be - - very number and detail oriented.”

the Controller continually describes “them”:

“- - the managers [in *Eurodivision*] are really number, I don’t know if it’s number orientation. They are really intelligent with their follow-ups, they have cross calculations all the time and so on. They calculate really quickly if the numbers are logical, really fast.”

The number of hierarchical steps thus shows in the perceptions. On the local (*Balticsubs*) level the owner’s requirements might seem even tighter:

“As we have a small firm, I understand that in a big organization like *Eurodivision*, there one wants to know a lot of things are really accurately. But we cannot always directly find the information so easily. So, sometimes one wonders if this is all worth it.” (*Estsub* CEO)

“- - in small companies we know personally another person. We know also, not just in work, we know also outside from work. And we know, we could trust this person or not to trust.” (Financial Director of *Latsub*)

Accordingly, reporting needs are different in the smaller companies. However, most of the reports required by the owner are seen as useful for local work and the reporting package followed by local CEOs mostly consists of the reports that are sent on to *Balticparent*. This indicates that disembedded numbers, when detailed enough, are actually not too distant from the local reality. In contrast, for the chief accountants the owners mostly appear as “more work to be done”:

“In Estonian we don’t have to make a report every month, but for Finnish and for [*Eurodivision*] I have to - - and if it’s only Estonian company, I don’t have so much work. But I think it’s good for me that I [can get] a lot of knowledge.” (Chief Accountant of *Estsub*)

Reporting forms the main job description of the chief accountants. The financial department also buffers the requirements towards other organizational functions, as the reports and other accounts are requested from them. The perceived strictness of *Eurodivision* is also reflected in comments from the people who have no direct contact with the company. The reports are required as scheduled, despite local national holidays.

“Everything is strictly timed, when everything has to be ready.”
(Accountant, *Finparent* and *Balticparent*)

“We have only five working days for [monthly reports] and it’s not enough. We [have to] predict lot of numbers. - - [*Eurodivision*] is very serious company - - very important for them is - - that our results are good. And it’s not important how we spend our time.”(*Estsub* Chief Accountant)

Otherwise *Eurodivision* is not visible in the local life. Different people from the parent sometimes visit also *Balticsubs*, but the concrete cooperation and contemplating how to fulfill *Eurodivision*’s requirements happens between *Balticparent* and the *Balticsubs*.

“[*Russub*] has only one parent company, [*Balticparent*]. [*Eurodivision*] is a grandmother. Accordingly, I seldom see the grandmother.” (*Russub* Chief Accountant)

4.3 *Balticparent* as a controller and developer of operations

Because of the personal experience of the people in *Balticparent*, practical controls towards different *Balticsubs* differ somewhat from each other. Both the Controller and the *Balticparent* CEO claim that they trust people in the Baltic countries more than those in Russia.

“But our starting point is, it is a fact that it is dishonest. My view is that it should be a Russian who creates a control and watching system for the Russians, because the moment you implement a rule the first thing a Russian thinks is how to bypass it. It comes from, it comes from the past. In a way it has been the only way to survive. Those, who have complied with the rules which existed, they have lived in a misery.” (Controller)

For example, the management in *Estsub* and in *Latsub* has been local right from the beginning, whereas *Russub* is still managed by Finns. Only the Finns (CEO and the second man of the firm, an outside consultant) can approve outward payments from the firm. The Controller describes the differences in control and trust as follows:

“- - like we said, we trust the Estonians the most. But it springs from the trust that you control in the different way even though you should control in the same way. A good example is that we monitor the mileage in Latvia. I make the kind of supervisions that I might take orders and deliveries of some period and check that all delivery notes are there and I follow some issues. But the most rigorous control focuses on Russia and Latvia, for Estonia it is looser. It is not obvious, however. It would perhaps be quite justified to control them as well. - - It is a fact that Estonians are closer to Finns. And if one thinks about trust, it is inside the country that there is no trust. - - in Estonia it is clear that we don't have many Russian employees there, but most of them are Estonians. And in Latvia it is the same that most of our employees are Latvians, they are not Latvian Russians. They don't trust the other group themselves, either. But the lack of trust comes also from behavior. For example, for Latvia, I think that they haven't earned our trust with their conduct. For example, if I ask for something, I won't get any answers. Or if I tell them to do something like this, I will notice later on that it has been done quite differently. But in Russia - - I have worked there and I know that one should not be too naïve. One can make everything seem great on paper if one does no question the process that is behind.”

On the other hand, some of *Eurodivision's* requirements are really buffered and softened. The Controller describes actions towards the *Balticsubs* as “rather soft” when it comes to budgeting:

“[*Estsub*] has always been the best in that they always clearly top their every target levels. We have perhaps been warm-hearted towards them, as they always can reach the budget. And then there are the bonuses, - -, they always get full bonuses. So we should set the targets a bit higher there. But I think, even psychologically we cannot demand too much. Until now their salaries are moderate so it is not too big of compensation if they get 20 per cent of their annual salary and they are really motivated.”

The Controller also says that she tries to be sensitive to mistakes. She has noticed that especially the local business culture in Russia and Latvia has little toleration for mistakes, which the tight requirements from the authorities also express.

Additionally, the controller claims that the *Balticsubs* are sometimes allowed to operate “too much as they want”. For example, there is a form of dual management in every subsidiary. In *Estsub* and *Latsub* the structure originates from the merging of two companies when *Eurodivision* acquired *Finparent*. In *Russub* the ultimate decision making is kept in Finnish hands by having a Finnish substitute for the CEO.

The differences between controls are explained by the occasions where the reported information from *Latsub* and *Russub* has not been reliable. In *Latsub*, for example, an overdue discount from a supplier had been recorded as sales and the account had not been corrected by the external auditors. An example from *Russub* concerns inventory valuation. Local accountants had confirmed accounts that showed the amount of inventory that was consistent with the bookkeeping. However, the physical inventory showed less than the accounts and significant losses were discovered in the financial statement. A particular control needed and used in the *Balticsubs* is the norms for fuel consumption. According to the experience the consumption precisely equals to the norm, even after changes in the norms. The Finns find this kind of behavior to be stealing, while for local business it is apparently a normal way of conduct as also the tax authorities have their own norms for fuel consumption.

The Finnish interviewees often equate Latvia and Russia also in other issues. In both countries state authorities and their demands seem still stricter than the Estonian ones, which implies also mistrust within the countries. Bureaucracy makes operating more complex, as e.g. the signatures of both the vendor and the purchaser are needed in order to make the invoice official. Besides, in Latvia the invoices need to be printed on special numbered sheets that can only be bought from the tax authorities. Local legislation also causes the need for adjustments of the reports

coming from especially *Russub*. Calculations on depreciation differ and smaller items can be capitalized than in Finnish (or other Western) bookkeeping. Therefore the reports are converted in *Balticparent* before consolidation.

In addition to the different conduct of authorities, the Business Development Manager's example may also indicate the existence of *blat* in Russia (see Ledeneva, 1998; Michailova and Worm, 2003):

“We have a project [in Russia] and there is one person there who has worked full-time for three years now to apply for clearances, and we still don't have the clearances.”

The *Russub* CEO has seen the importance of personal networks and favors in operations. This is evident as participation in the networks of other CEOs enables careful monitoring of the rapid changes in the markets and reacting to them. Capital expenditures might also be arranged quickly through personal contacts, but these possibilities might be lost as the expenditures need to be approved by *Eurodivision*. Therefore the intermediate as a buffer also has some negative attributes as the hierarchical organization structure becomes inflexible if fast decisions are needed in the fast-changing environment. However, personal contacts and knowledge about the markets are needed also outside Russia. The Business Development Manager describes the beginning stages of a recent acquisition:

“Well, [the acquired company] has been our biggest competitor in Tallinn for many years and then the opportunity just came. [*Balticparent* CEO] went there to discuss with the management and then we just all of a sudden realized that the firm is on sale. Often they do not announce it, one just have to get it. One just has to go, meet a lot of people and then something might come out of it.”

As described above, the Balticsubs face a different business environment from the ones in the Western world. On the other side strict requirements originate from *Eurodivision*. In between the rock and the hard place the Controller asks for the

help of the local Chief Accountants in order to fulfill the reporting requirements, but to fulfill the actual targets, operations must be continuously developed. *Eurodivision* does not offer any formal requirements for the practical operations of its subsidiaries, whereas *Finparent* goes to the local circumstances to do the business in its own way. For example, were many Finnish expatriates in the different functions of *Russub* at the start there to teach the locals how to run the firm in a Finnish way. Later on, as the locals learned the conventions, the Finnish presence has diminished. The local operations are still developed in cooperation with local and Finnish experts. The importance of Finnish parent companies has also been noticed in the subsidiaries:

“*Finparent* has so much experience on this business. That is good. And another good thing is that someone is near and when it is easy to communicate - - one possibility would be that we would report straight to the head office, but I don't think it matters. Maybe it is yet easier for us to communicate. Things go along quickly and rationally through *Balticparent*. I think it is a good system. - - sometimes it feels like, as we are related, Estonians and Finns.” (*Estsub* CEO)

However, applying Finnish processes directly in the *Balticsubs* might not even work as the local environment is constantly changing and developing more rapidly than the business environment in Finland. Even the production formulas need to be changed because of the local differences in materials. *Russub* CEO describes operating in Russia where *e.g.* tax laws and material prices might, overnight, face a major unpredictable change:

“You need to be updated all the time, to know the situation and not to lock into old patterns saying that this was done like this in 98 so it will be done similarly now. Times are changing, ways are changing, and one needs to be flexible and quick-moving.” (*Russub* CEO)

Because of the different circumstances, *Balticparent* has not hastened to implement similar information systems to the *Balticsubs* that are used in Finland, even though they might rationalize the operations. The requirements of the local authorities cause

bureaucracy and intensive documentation, which hinder any efficient use of many Western information systems. Some development has, however, been done. For example, the Controller has made efforts to implement her pet project, an information system dealing with orders and deliveries for the business *alpha* in *Estsub*. However, the development work is free from any formal directions, even from *Finparent*, as the processes are not implemented in the *Balticsubs*. Actually, the development in the *Balticsubs* is mostly dependent on the expertise of the people in *Balticparent* and other Finns do not meddle with the operations. Finnish expertise is available, but it mainly comes through *Balticparent*. This shows also in the financial function and the Controller feels her position to be sometimes difficult:

“My job description is undefined, I can do things very independently and I’m not directed much from Finland. It would be much clearer if I had better guidelines about what I should go through with the auditors, because I haven’t been in this kind of a job before.” (Controller)

Despite the hierarchy the managers of *Balticsubs* see *Balticparent*’s management as a valuable partner in cooperation and negotiation towards *Eurodivision*, which can be seen in the quote from the *Latsub* CEO:

“- - our Finnish parent company promised that they will push through some development projects in Latvia for our company. They will push through [*Eurodivision*]. Because we need to have [*Eurodivision*’s] approval.”

The locals see *Balticparent*’s central role in capital expenditure proposals to be of value in coping with *Eurodivision*’s requirements. The centrality of capital expenditure control is reflected by the post of the Business Development Manager in *Balticparent*. His job is to help preparing capital expenditures (from acquisitions to smaller expenditures for production) with the local people, negotiating with locals and calculating models for estimating the gains for capital expenditure proposals. The proposals are finalized by the Controller with the help of people in *Eurodivision*.

The Finnish parent companies have provided stability for the *Balticsubs* despite many changes. In addition, the key persons (management and chief accountants) of the *Balticsubs* have been working for their firms for a long time.

“[*Balticparent*] is not so jumping left and right and doing unexpectable decisions and then you don’t understand what, how it happened. We go step by step and people are quite stable.” (*Latsub* CEO)

Finparent has had many owners and on the other hand, the controllers of *Balticparent* have changed as many controllers have moved to other posts, also within *Eurodivision*. However, the main relationship has remained the same as *Balticparent* and the *Balticsubs* cooperate to fulfill the (reporting) requirements of the owner and to develop the local operations, the actual business. The acquisition by *Eurodivision* was felt in the *Balticsubs* mainly, when the subsidiaries in Estonia and Latvia, dealing with different businesses, were merged so that only one subsidiary per country (*Estsub* and *Latsub*) was left. Local accountants buffer the change also here as they were responsible for supplying the needed numerical data for the new owner in cooperation with *Balticparent*.

5 Discussion

According to Giddens (1990), expert systems as disembedding mechanisms remove social relations from the immediacies of context. Following Giddens’ (1990) definition, the total control system of *Eurodivision* is an expert system administered by accounting professionals. Accounting is the logic for controlling and steering the operations (cf. Kirk and Mouritsen, 1996) and it communicates the social relations of the parent to the subsidiaries. In addition, the subsidiaries need to present and conceive themselves according to these disembedded social relations, since they

prepare the reports along with the parent's logic. However, the total system can be seen to be consisting of smaller expert systems in different parts of the organizations. Therefore, this section analyzes how the requirements from *Eurodivision* roll hierarchically down in the organization and why they become filtered through the social structure of the intermediate(s), *Finparent* and *Balticparent*.

Despite the occasional visits of *Eurodivision* representatives to its subsidiaries, *Eurodivision's* control system is strictly based on numbers and financial control (see Merchant, 1985). Therefore, *Eurodivision's* control system has a distinct set of signifiers according to which business is discussed. The most important measures (volume, average price and EBIT) are universally applicable indicators, meaning that such issues are certainly followed and nowadays also understood on the local level. However, when these signifiers are connected with the ones restricting the increase in assets and the overall focus on number-format signifiers, the concepts and rules forcefully communicate the importance of growth and value to the subsidiaries. Even though these are indisputably the goals for all businesses, the execution of *Eurodivision's* control creates a perception of tight and strict control in the intermediate.

Legitimated behavior in the corporation seems to consist of fulfilling the targets and schedules in a logical manner. On the other hand SOX requirements make the definitions of legitimated behavior visible as actions need to be documented and the hierarchical relations are enforced. Overall, regularity and certain linearity in the business seem to be legitimated. These structures become concrete to the people in subsidiaries (with few direct contacts with *Eurodivision*) in the mental picture of an organization whose work is based on fiddling with numbers in spreadsheets and spotting the incoherence in reported data. The most obvious

manifestation of the domination structure is strictly holding back the right of decision on capital expenditures. This domination is explicitly felt in the *Balticsubs* and *Balticparent* as efforts are needed for preparing the proposals and trying to plan for the future to be able to justify the needs for expenditures. However, as Giddens (1984) notes, the domination is power only in the narrow sense while power in the broad sense is the ability to get things done (see also Macintosh and Scapens, 1990). Accordingly, it is the power in the broad sense what enables the role of the intermediate firm. *Eurodivision's* social structure is a way to communicate the desirable results of business actions and also give some guidance how these actions should be done, as rather detailed data are followed. However, the autonomy provided by results controls (see Merchant, 1985) enables local discretion for applying the guidelines illustrated in the targets (cf. Quattrone and Hopper, 2001; Barrett et al., 2005).

Giddens (1990) argues that processes of reembedding, which is acting upon the information based on disembedded social relations (see also Jones and Dugdale, 2001), require trust, as there is a risk that the information does not give an accurate view of local issues. *Eurodivision* tries to reduce risk (enhance trust) by crushing the numbers into smaller and smaller parts. For local people this indicates *Eurodivision's* basic mistrust of local systems. However, along with Giddens' (1990) view, *Eurodivision's* control is solely based on trust on their own expert system. *Eurodivision* trusts in the accounting principles applied for reports to be universally applicable and also ensures the trustworthiness e.g. with making cross calculations and asking supplementary reporting whenever needed. Accordingly, personal contacts are not necessary, since trust-in-systems obviates trust-in-persons and makes consideration of the local systems pointless.

Eurodivision's social relations become filtered through the ones of *Finparent* and *Balticparent*. Thus, the control system is perceived to be rather stable in the *Balticsubs*, as the parent's requirements and changes in them do not directly touch the locals. Since the intermediate subsidiary has power for its own discretion despite the seemingly strict requirements of the parent company, the filtering effect in disembedding and reembedding is based on the experience and perceptions of the personnel. Actually, *Balticparent's* people as the access points to *Eurodivision's* control system do not necessarily work solely to reinforce local faith in the total system. The Finnish people regard *Eurodivision's* system with some suspicions. The focus on accounting and the requirements for documentation create a perception of strict watch, which does not suit to the Finnish mentality or a Finnish firm. However, strictness is also felt from the other side, from the business environment of the *Balticsubs*. If the Finnish people somewhat distrust *Eurodivision's* system they are also suspicious towards the local systems and structures in the *Balticsubs* and their environment. They see that the local systems affect the behavior of the people, so that the local persons might not be as trustworthy as Finnish people would be. From the intermediate's point of view local social structures are somewhat stamped by dishonesty and self-seeking, which also leads to some domination and strict requirements from the local state authorities.

People in *Balticparent* have seen that expert systems can provide logical but biased information so that abstract trust on the systems is not enough. Additionally, experience has shown that locally there is a tendency to try to bypass any rules, which, from *Balticparent's* view, creates the need to complement the total accounting-based control system with their own system and experience. This has led to inequalities in the tightness of the control towards different *Balticsubs* so that

where more risk is perceived (Latvia, Russia), tighter control is utilized so that more issues are controlled and watch is kept more carefully.

Working in between parent's and local demands, the intermediate sees so called "more human" point of view, doing the business in a Finnish way and resting on the Finnish morals, to be legitimated. It creates the need to hang on to own social structures and rely on them more than totally adapting to the social system of the parent. Since the cooperation between the *Balticsubs* and *Finparent* has been about developing the operations right from the beginning, the communication is more based on the language of the local markets, not on the abstract financial terminology, which frames the signification structure of *Eurodivision*. Difficulties are handled more in face-to-face interaction than with sanctions and punishments. Domination seems to be more of a subtle kind, as discussions are preferred to dictations. A concrete example is that the budgets are not always tighten up to some upper limit so that it would be more motivating for the local to work, having good possibilities for annual bonuses.

The intermediate (*Finparent/Balticparent*) concretely rationalizes its existence and intervenes in the processes of disembedding and reembedding in planning and reporting by reserving itself a material role in filtering the data. For instance, the capital expenditure proposals are finished in *Balticparent* so that the people in the *Balticsubs* are not directly in touch with the forms of the proposals, but *Balticparent* asks for the information it needs. In addition, the *Balticsubs*' reports are made up of the figures from local bookkeeping and the adjustments, especially needed for the information prepared according to the Russian legislation, are also done in *Balticparent* by the Controller. In this way, the locals still give away their local information, which is then translated into *Eurodivision*'s language in

Balticparent. In addition, the financial function mostly feels the disembodied requirements and thus acts as another buffer, also on the local level. The financial function takes the changes in reporting and the tightness of the disembodied requirements. Nonetheless, some of the *Eurodivision*'s requirements are more promptly enforced downwards. For example, the timetables are strictly adhered to and the organizational hierarchy is followed in decision making.

Consequently, the focus on financial controls highlights the role of financial personnel and creates buffers, which again create hierarchy. This means that the focus on financial controls shapes abstract spatial arrangements (cf. Carmona et al., 2002; Ezzamel and Willmott, 1998; Miller and O'Leary, 1994; Quattrone and Hopper, 2005) even though the hierarchy as accounting space (cf. Kirk and Mouritsen, 1996) closely complies with the defined organizational structures. The only exception is the dual role of the Controller, who is officially part of the financial function of *Finparent*, but still working for (and virtually in) *Balticparent*. Therefore, the stability provided by the intermediate also creates hierarchy, which actually is inefficient in situations where quick decisions would be needed in rapidly changing transitional environments. In this way, the intermediate rationalizes and also legitimates its existence by on one hand highlighting its role in translating the data between the parent and the subsidiaries, and on the other, by complementing the control system with concrete cooperation as trust-in-systems should be reembedded into people and trust-in-persons.

6 Concluding remarks

The purpose of this paper is to analyze the role which a subsidiary plays in the control system of a multinational corporation. It contributes to the understanding of the role of an intermediating subsidiary in multinational MCSs. The analysis utilizes the notions of disembedding and reembedding (cf. Giddens, 1990; Jones and Dugdale, 2001) to explore how and why the intermediate maintains the control towards its subsidiaries in the area of the former Soviet Union. The results show that even though the parent's requirements are not decoupled from the local work, but the issues reported to the parent are of concern also locally (cf. Siti-Nabiha and Scapens, 2005), the parent's social relations do not totally displace the ones of the subsidiaries or the ones of the intermediate. This happens, because the intermediate pursues to use its autonomy and power, provided by results controls (cf. Merchant, 1985), in order to rationalize and legitimate its status and existence, even though the hierarchy causes inflexibility in an environment where flexibility is needed.

Despite the strict requirements from *Eurodivision*, the intermediate subsidiary actively participates in the reembedding process because of its facework commitments and freedom for organizing operations and controls in the *Balticsubs*. Therefore, the intermediate (especially *Balticparent*) has quite a lot of power as neither the SOX requirements nor the guidelines from *Finparent* restrict the execution of control. This is rationalized as being motivating for the local people so that the locals would not have to work between the devil and the deep blue sea (local authorities vs. *Eurodivision*). The social structures between the intermediate and local subsidiaries seem also to be based on the operational experience and know-how, which is communicated to be helpful for the locals in contrast with the pure number requirements coming from the parent company. The legitimation might also be necessary as the strict requirements are in a way commonplace for the locals and

the locals have already adapted to the Western way of reporting during the long cooperation. Therefore, from the financial control point of view the intermediate might not be needed. Besides, the intermediate brings another level to the organizational hierarchy which might impede the local operations - for example by delaying the decisions on capital expenditures.

The results of this study suggest that the differences in accounting and business traditions between the West and the former Soviet Union still exist (cf. Enthoven et al., 2001; Sokolov and Kovalev, 1996) and that Western firms do provide help for their partners in developing operations and internal control (cf. Southworth, 1994; Firth, 1996). However, there is no evidence on how long this help is needed. The current theoretical framework unveils how different organizational (and national) cultures interact in the hierarchical organization structure and how power can be used in different parts of the organization to rationalize actions taken. This is why the sociology of modernity is utilized, even though the stability in management accounting and control could have been explored, e.g. with a help of some institutional framework such as the one of Burns and Scapens (2000). The results also indicate that accounting-based control is somewhat neutral and balanced towards different subsidiaries, because the only thing needed is the abstract trust in the principles of accounting. However, a Western firm easily regards a subsidiary in transitional economy with some suspicions and thus might treat subsidiaries differently, because trust-in-persons is challenged by somewhat stereotypical views. These views are also rather strong forces in the construction of a control system and they are not only characteristic to facework commitments, but somewhat exist also in personal contacts.

Naturally, this study suffers from some shortcomings. Firstly, the data are rather small. Despite this, all the focal persons (bar the *Balticparent's* Technical Director) were interviewed. Another shortcoming is the omission of the viewpoint of *Eurodivision*, as the study focuses on the perceptions of the people from *Balticparent* and the *Balticsubs*. Thus, this study lacks an analysis of how the whole corporation functions (cf. Kristensen and Zeitlin, 2005) and does not provide any evidence how the intermediate's role is perceived in the head office. On the other hand, the interviewees were able to express their thoughts about *Eurodivision* more freely, and, because of this confidentiality, they hoped that the parent company would not be included in this research. Some language problems arose in the interviews, as the chief accountants were not fluent in English. In Estonia, the interview was conducted in English, however, and in Latvia and Russia the speech was translated by a colleague from the firm. The translation was between Latvian and English, and Russian and Finnish, respectively. Some of the interviews are also rather short, but the interviews with most focal persons are of considerable length.

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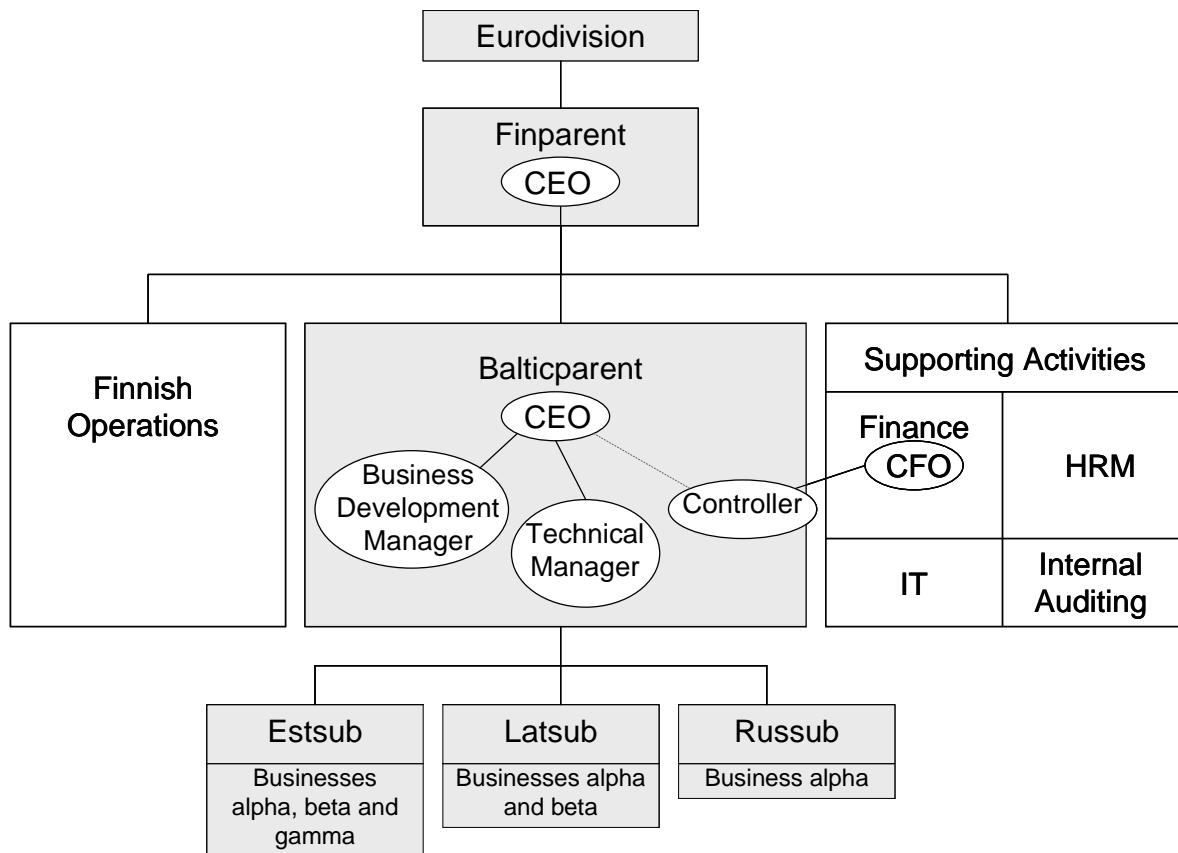
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Figure 1.

Organization structure in the case



Appendix

Details of the interviews

Interviewee(s)	Time frame	Location, language(s)	Contents briefly
CEO of <i>Balticparent</i> and Controller of <i>Balticparent</i>	29 June, 2005 2 hours	Finnish head office, Finnish	Basics about the corporation and its operations in Baltic area and Russia, Management Control System with reference to those units. Effects of multinationality on operations.
Chief Accountant and Vice President of <i>Estsub</i>	10 April, 2006 1 hour	Estonian office, Finnish and English, Estonian translated	Development of the operations in Estonia, personal job descriptions and duties, contacts with the parent companies
CEO of <i>Estsub</i>	10 April, 2006 30 minutes	Estonian office, Finnish	Personal background, operations in Estonia, personal job description and duties, reporting and contacts with parent companies.
Accountant, responsible for accounting for both <i>Finnparent</i> and <i>Balticparent</i>	6 June, 2006 15 minutes	Finnish head office, Finnish	Briefly on personal job description, contacts and reporting
CFO of <i>Finnparent</i>	6 June, 2006 45 minutes	Finnish head office, Finnish	Personal job description and duties, strategic planning and strategy implementation, reporting, contacts, SOX
Business Development Manager of <i>Balticparent</i>	6 June, 2006 30 minutes	Finnish head office, Finnish	Personal job description and duties, contacts, operating in the Baltic area and Russia
Controller of <i>Balticparent</i>	6 June, 2006 1 hour	Finnish head office, Finnish	Deepening the understanding of the issues raised in the first interview, personal duties and contacts
CEO of <i>Russub</i>	25 August, 2006 1,5 hours (of which 45 minutes recorded and transcribed)	CEO's home in Finland, Finnish	Personal background, operations in Russia, personal job, reporting and contacts with parent companies, local issues.
CEO of <i>Latsub</i>	13 October, 2006 30 minutes	Latvian office, English	Personal background, operations in Latvia, personal job, reporting and contacts with parent and sister companies, local issues.
Financial Director and Chief Accountant of <i>Latsub</i>	13 October, 2006 30 minutes	Latvian office, English, Latvian translated	Personal background, operations in Latvia, personal job, reporting and contacts with parent and sister companies
Chief Accountant of <i>Russub</i>	31 October, 2006 30 minutes	Russian office, Finnish, Russian translated by the secretary of <i>Russub</i>	Personal background, operations in Russia, personal job, reporting and contacts with parent and sister companies
(Finnish) Consultant to <i>Russub</i>	31 October, 2006 1 hour (not recorded)	Russian office, Finnish	Informal conversation, personal experience on business in Russia, the role of parent companies