

# Chapter 10

## Formal and Informal Coordination Mechanisms

As has been shown in the preceding Chapters, MNCs are characterised by internationally dispersed activities. To integrate all of an MNC's activities and organisational units under a common strategy, coordination is necessary. This Chapter is an overview of different coordination mechanisms, including the strengths and shortcomings of each mechanism.

### Introduction

The successful implementation of international strategies strongly depends on adequate coordination of the dispersed activities by the MNC (e.g., Andersson/Forsgren 1996, p. 487), mostly by the MNC's headquarters. Solving the problem of coordinating *heterogeneous and geographically distant subsidiaries* is an essential part of International Management.

Coordination can be defined as the process of integrating activities that remain dispersed across subsidiaries (Martinez/Jarillo 1991, p. 431). "A mechanism of coordination is any administrative tool for achieving integration among different units within an organisation, i.e. to align a number of dispersed and yet interdependent international activities" (Martinez/Jarillo 1989, p. 490).

The core coordination task for an MNC is to ensure that all subsidiaries strive towards *common organisational goals* and the actions and behaviour of the subsidiaries conform to the MNC's overall strategy. At the same time, coordination must support the necessary capabilities, *motivation* and entrepreneurship of the subsidiary management in adapting to the local environment of their host countries (Macharzina 1990, p. 372). This should be achieved with minimum management costs (or *agency costs*). So-called *administrative rationality* (Thompson 1967) argues that the most efficient type of coordination should be chosen in each situation.

Usually, many coordination mechanisms are used simultaneously. Bartlett/Beamish (2014, pp. 287-289) suggest an illuminating analogy between the MNC and the human body. They argue that three different types of mechanisms are necessary to coordinate the MNC:

- The *anatomy* of the organisation, i.e., the formal organisational structure, which is necessary but not sufficient.

*Coordination  
and  
Coordination  
Mechanisms*

### Formal and Informal Coordination Mechanisms

- This must be accompanied by the *physiology*, i.e. a company's systems and decision processes.
- The final (crucial) component is *psychology*, i.e. the organisation's culture.

A broader categorisation groups the coordination mechanisms into two sets of mechanisms: formal and informal. Informal mechanisms are more subtle. Table 10.1 gives an overview of the most common coordination mechanisms.

Table 10.1

The Most Relevant Sets of Coordination Mechanisms

Formal Mechanisms	Informal Mechanisms
<b>organisational structure:</b> departmentalisation or grouping of organisational units	<b>lateral or cross-departmental relations:</b> direct managerial contact, temporary or permanent teams, task forces, committees, integrators, and integrative departments
<b>centralisation:</b> centralisation or decentralisation of decision making through the hierarchy of formal authority	<b>informal communication:</b> personal contacts among managers, management trips, meetings, conferences, transfer of managers, etc.
<b>formalisation and standardisation:</b> written policies, rules, job descriptions, and standard procedures, through instruments such as manuals, charts, etc.	<b>normative integration:</b> building an organisational culture of known and shares strategic objectives and values by training, transfer of managers, career path management, reward systems, etc.
<b>planning:</b> strategic planning, budgeting, functional plans, scheduling, etc.	

Source: Adapted from Martinez/Jarillo 1989, p. 491.

## Formal Coordination Mechanisms

### Structural Coordination Mechanisms

The formal organisational structure is concerned with how the company decides to *divide itself into subunits* (Hill 2013, pp. 452-453). This has far-reaching consequences for information flow within the organisation, decision processes and the allocation of resources. The formal organisational structure is discussed in detail in Chapter 11.

#### Macro Structure: a Rather Crude Coordination Mechanism

However, the *macro structure* of integrating subsidiaries into the organisational structure of an MNC is a "very crude" instrument for controlling activities (Birkinshaw/Morrison 1995, p. 737). The basic organisational types describe the general structure of the organisation at the highest organisational level. Given that subsidiaries act in diverse external contexts with unique constellations of characteristics and resources and different tasks, a uniform organisational structure is hardly sufficient to consider this hetero-

generity (Nohria/Ghoshal 1997, p. 4). Structural coordination mechanisms are generally symmetrical and not tailored to the needs of a specific subsidiary. Hence, they are chosen based on the overall requirements of the MNC.

### Centralisation/Decentralisation

Centralisation refers to *the locus of decision power*. It determines the degree to which decision-making authority is concentrated in the higher hierarchy levels of the organisation (e.g. Lawrence/Lorsch 1967a). For international business, it indicates the degree to which decisions are taken by the corporate HQ in the home country or by the subsidiary itself. It also determines the strength of the subsidiary's influence on these decisions (Morrison/Roth 1993, p. 802).

Obviously, strongly integrated behaviour of different organisational units can be achieved if all decisions are taken by the HQ and the subsidiaries only implement those strategies without any autonomy. Decisions taken centrally are based on a good overview of all the different parts of the MNC and fully reflect the requirements of the HQ. Centralisation is particularly suitable for enforcing *global strategies*.

However, strong centralisation has various drawbacks. First, centralisation has negative effects on the motivation of subsidiary managers. Resistance against a high degree of centralisation is common. Also, centralised decisions are taken based solely on HQ's. While HQ has a total picture of all parts of the MNC, its knowledge of each specific host country is limited. If a subsidiary's situation is complex and the environment and requirements are very different from those in the home country, the knowledge of the HQ is unlikely to be sufficient to make adequate decisions. Since centralisation also needs *intensive information flows* across hierarchies, such decisions are often slow, and decentralisation is better suited to quick and flexible reactions to changes in the local environment and to exploit local market opportunities (Nohria/Ghoshal 1997, pp. 97-98). MNCs with a *multinational orientation* are more likely to use decentralisation.

Centralisation or decentralisation of MNCs is influenced by many factors (see the overviews by Welge 1987, c. 1539; Young/Tavares 2004; Rugman/Collinson 2012, p. 289). Decision centralisation tends to be higher if a subsidiary

- belongs to a large MNC that is active in many countries
- is relatively important to the MNC
- is responsible for more than the local host market

*Advantages of Centralisation*

*Disadvantages of Centralisation*

- is interdependent with the MNC with intensive product flows between the different subsidiaries
- is located in a host country with low cultural distance to the home country
- is located in a host country with relatively stable political conditions.

On the other hand, subsidiaries are usually granted a high level of autonomy if

- they belong to an MNC with a high growth strategy
- they are oriented towards the local host market
- they are tightly embedded in a local cluster within the host country
- local investors hold a substantial capital share
- the products and services that the subsidiary offers are not related to the products and services offered by the parent company
- the geographical distance between home country and host country is large and/or
- the local environment of the subsidiary, in particular market and competitive conditions, is very dissimilar from that of the home country.

#### *Different Levels of Centralisation of Different Functions*

#### *Strategic Decisions Stronger Centralised*

The level of centralisation might also differ across the functional areas of the MNC. While financial management and R&D decisions are often highly centralised, human resource management is usually the least centralised. Manufacturing and marketing fall in between (Young/Tavares 2004, p. 218).

Strategic decisions are more likely to be centralised, while operational decisions are often decentralised. The different availability of information needed for these decisions is an important factor. While the knowledge necessary for long-term and strategic decisions is often more available at the HQ, subsidiaries are granted more autonomy for operational decisions in which they have better access to information and which need quick decisions, especially if they have few far-reaching consequences for the overall MNC (Young/Tavares 2004, p. 218).

#### *Centralisation AND Decentralisation*

More recent literature does not view centralisation and decentralisation as purely opposing mechanisms. In particular, *transnational strategies* might require “avoiding the simplistic centralization-decentralization dichotomy” (Martinez/Jarillo 1989, p. 500). As explained in Chapter 1, networks can be coordinated via so-called *decentralised centralisation*, where activities are globally integrated and aligned; however, in some cases and for some prod-

ucts, a foreign subsidiary rather than HQ acts as a strategic leader for worldwide activities (Birkinshaw/Morrison 1995, p. 734).

### Formalisation and Standardisation

Formalisation and standardisation refer to the extent to which *written policies*, rules, job descriptions, standard procedures, etc., are established and written down in manuals and other documents. Procedures are established through *standard routines*. The intention is to provide clear and formal behavioural guidelines to subsidiaries (Lawrence/Lorsch 1967a; Martinez/Jarillo 1989, p. 491). Formalisation, as a bureaucratic mechanism, can be seen as the *routinisation* of decision behaviour (Hedlund 1981). It defines impersonal rules and standard processes, independent of specific persons or situations. Standardisation refers to binding rules for uniform procedures and programmes that lead to homogeneous task completion.

In management practice, standardisation and formalisation have become considerably more important due to *quality management* procedures (e.g. ISO 9000), environmental management (e.g. ISO 14000), compliance rules for corporate governance and *codes of conduct* for corporate social responsibility (see Chapter 13). Most of these management systems require a formalised written set of standards and conducts that are applied throughout the company.

A high level of product flows and cross-border production usually requires higher levels of standardisation and formalisation for production processes to facilitate an optimal workflow and the integration of products and product components into a single worldwide supply chain.

The basic advantage of formalisation and standardisation as a coordination mechanism is that they identify certain routine situations that occur repeatedly and establish generalised decision rules before those situations occur. Their coordination effect is particularly strong if they group potential decisions and activities into categories. Thus, they help to replace direct, centralised coordination with an indirect form and reduce coordination costs (Morrison/Roth 1993, pp. 802-803). Compared with decision centralisation, formalisation and standardisation provoke less resistance since they refer to a generally valid set of rules instead of potentially “unfair” decisions (Nohria/Ghoshal 1997, pp. 99-100).

However, since formalisation and standardisation have to solve problems *ex ante* (i.e., before the decision is taken), they are best suited to static problems and rarely suitable for highly dynamic tasks in complex environments. They lead to standardised solutions which might be a *barrier to flexibility* and new and innovative solutions. They also reduce the ability to adapt to local con-

*Formalisation as Part of Quality Management and of CSR*

*Advantages of Formalisation/Standardisation*

*Adequate in Stable Task Environments*

### Basis for Horizontal Relations

ditions and might thus reduce the motivation of local management.

On the other hand, formalisation and standardisation might help to establish a stable context for bilateral communication and coordination between subsidiaries. Even in inter-company cooperation (e.g. in supply chain management), *common standards* (for data and processes) are increasingly seen as necessary *enabling technologies* for true cooperation (see Zentes/Morschett/Schramm-Klein 2011, pp. 371-372). In the MNC context, formalisation and standardisation are certainly insufficient for complex situations, but they can provide fertile ground for the use of other coordination mechanisms (Morschett 2007, pp. 507-511). Lateral agreements, horizontal cooperation, etc., are facilitated if formalisation and standardisation provide standards that help to exchange products, data and information and facilitate cross-border production processes, marketing strategies, etc. For MNC control, a common definition of key performance indicators, etc., is necessary for *internal benchmarking*.

### Planning

Planning, understood as the *periodically repeated establishment of goals* and objectives by HQ for subsidiaries, is a process of *ex ante coordination*, in which higher-ranking organisation objectives broken down into lower hierarchy goals and specified stepwise. It refers to systems and processes like strategic planning, budgeting, establishment of schedules and goal setting (Martinez/Jarillo 1989, p. 491). Qualitative strategic objectives are transformed into quantitative objectives, and those objectives are linked to specific resources and organisational units and given a specific time frame. Thus, subsidiaries receive concrete objectives from the HQ that are established to guide and channel the activities and actions of independent units.

## Informal Coordination Mechanisms

### Lateral Relations and Informal Communication

Lateral relations are established *across the formal hierarchical structure*. They directly link people in the organisation who share common problems and might develop joint solutions together, without relying on clear vertical lines of authority. The top management's decision and information task is reduced by these *direct horizontal relations*. They include direct contact among managers of different organisational units, temporary or permanent task forces, teams, cross-national committees, integrating roles, integrative departments,

etc. (Martinez/Jarillo 1989, p. 492). These lateral relations establish common procedures, internal discussion, knowledge sharing, etc., in the organisation.

Lateral relations also enhance informal communication by creating a *network of informal and personal contacts* among managers across different company units (Martinez/Jarillo 1989, p. 492). Such *informal communication* can be stimulated by corporate meetings, management trips, personal visits, manager transfers, intensive use of expatriates, etc. They are associated with intensive direct communication, whether in person or via electronic media (e.g. video-conferencing). Frequent meetings and visits by representatives of the HQ to the subsidiary or vice versa are commonly employed (Kieser/Walgenbach 2003, pp. 109-110).

### Normative Integration

Normative integration (also called *socialisation*) refers to building a strong *organisational culture* of known and shared strategic objectives, perspectives and values. This is often achieved through a *socialisation process*, openly communicating the method of doing things and the decision-making style, training, management transfers, career path management, measurement and reward systems, etc., to generate identification with the organisation, developing incentive systems, etc. (Egelhoff 1984).

One tremendous advantage of this subtle and indirect mechanism is that the subsidiary can conduct its daily operations autonomously without direct orders from HQ. The subsidiary will have very *high flexibility* and the opportunity to adapt to the local context, and its conduct will still be aligned with company goals (Birkinshaw/Morrison 1995, p. 738). Normative integration as a coordination mechanism is discussed in detail in Chapter 12.

### Evolution from Formal to Informal Mechanisms

Simple strategies need little coordination and are easily implemented by using structural and other formal mechanisms. More *complex strategies* need a much higher coordination effort, and are therefore implemented through a more complex set of coordination mechanisms. In particular, network oriented, transnational strategies are more complex since they focus on the dual need of achieving global synergy effects and exploiting local market differences. Thus, in addition to structural, formal and relatively simple tools, informal, more subtle and sophisticated instruments are used. However, since these instruments are very costly and rather slow to implement, an MNC usually only applies these informal instruments if they are really necessary to implement a strategy (Martinez/Jarillo 1989, p. 492).

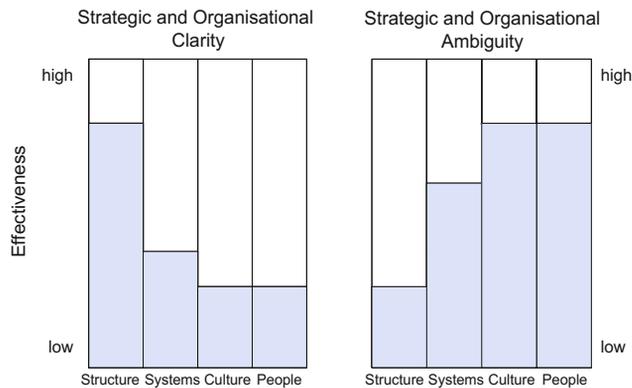
*Organisational Culture*

*From Simple to Complex Strategies*

In an early study by Hamel/Prahalad (1983), it was argued that in a situation with relatively stable and clear external conditions, structural coordination instruments have the highest effectiveness. In situations which are ambiguous, complex or involve dynamic environments, however, normative integration and other personal coordination instruments, like informal communication, are the most effective (see Figure 10.1).

Figure 10.1

Effectiveness of Different Coordination Mechanisms



Source: Hamel/Prahalad 1983, p. 349.

### Patterns of Evolution

Over time, a *pattern of evolution* can be observed. More and more MNCs are beginning to focus on subtler and more informal mechanisms, abandoning their unidimensional focus on structural issues (Martinez/Jarillo 1989, p. 489). This is often the result of a change in external environment and a move towards more complex strategies, which shifts the relative effectiveness of the different coordination mechanisms.

### Adaptation of Coordination to the Subsidiary

Given that coordination mechanisms have different strengths and weaknesses and the effectiveness and efficiency of certain coordination mechanisms are at least partly dependent on the role of the subsidiary (see Chapter 3), then it follows that the use of coordination mechanisms should vary between different subsidiaries (Young/Tavares 2004, pp. 220-221). Since the organisational structure cannot be adapted to the specific subsidiary roles, informal mechanisms are necessary to adapt coordination. However, formal mechanisms like the level of centralisation or autonomy are still necessary.

## Selection of Coordination Mechanisms

The economic perspective, based on so-called *administrative rationality* (Thompson 1967), argues the most efficient type of coordination must be selected in each situation. This entails considering the cost and effectiveness of each instrument.

Normative integration is a powerful instrument but costly to implement, since comprehensive administrative resources (e.g. visits by managers) require investment, for initial socialisation as well as maintaining the relationships. Formalisation and standardisation, on the other hand, are usually inexpensive to implement. Centralisation is also comparatively inexpensive to establish, since it is based on the hierarchical authority of the HQ. On the other hand, centralisation might require comprehensive resources within the HQ to be able to make decisions adequately (Nohria/Ghoshal 1997, pp. 102-103). These and other cost aspects must be balanced with the differing effectiveness in different situations to decide on optimal coordination.

From a theoretical perspective, the *contingency approach* (which is explained in more detail in Chapter 6) convincingly argues that there is no universally optimal way of coordinating an MNC. Instead, organisational coordination should be differentiated by the characteristics of the external environment in which the organisation acts (Lawrence/Lorsch 1967b; Thompson 1967) and other contingencies. Furthermore, *configurational perspective* suggests that a company should not focus on coordination instruments separately; instead a *holistic perspective* is necessary. The interplay between coordination instruments, and the resulting requirement for internal consistency between the coordination instruments applied which has a strong influence on the efficiency of the organisation (Khandwalla 1973, p. 493).

## Conclusion and Outlook

Coordination mechanisms are administrative tools for achieving integration among different units within an MNC, i.e., to align a number of disparate yet interdependent international activities. They are used to ensure that all subsidiaries strive towards common organisational goals (Martinez/Jarillo 1989).

With the increasing complexity of MNC strategy and heterogeneous environmental contexts, managerial practice has evolved from the use of simple instruments like organisational structure to more complex instruments like normative integration. These informal mechanisms supplement the formal mechanisms rather than replace them. Thus, MNCs increasingly apply multi-dimensional combinations of coordination mechanisms instead of the uni-

*Normative Integration More Costly Than Formalisation*

*Contingency Approach - "It All Depends"*

*Network-  
Oriented  
Perspective*

dimensional focus on company structure seen in the past. Following the configurational approach, it is important to consider MNC coordination as being realised through a combination of coordination mechanisms. These specific use patterns of coordination instruments build on an optimal bundle of instruments that supplement each other's strengths and weaknesses.

The modern network-oriented perspectives of MNCs strongly favour informal and more subtle mechanisms. In this context, Bartlett/Beamish (2014, p. 386) argue that a process of change within a modern MNC is better initiated through corporate culture rather than using the formal structure. They argue that using the formal structure as a coordination instrument is a blunt and slow mechanism which might take years to fully implement. To instigate change, instead of installing a new structure, HQ should employ other instruments. Following their analogy of the human body, they recommend starting a process of change by altering the company's "psychology", i.e. the corporate culture. After changing beliefs, norms and attitudes, changing the "physiology", e.g. communication and decision processes, can reinforce this *cultural change*. Later, companies might consolidate and confirm their progress by realigning organisational anatomy through a change in the formal structure.

However it must be remembered that more complex coordination systems are only suitable when the situation requires them. "Simplicity, wherever possible, is a virtue" (Ghoshal/Nohria 1993, p. 24).

### Further Reading

MARTINEZ, J.; JARILLO, C. (1989): The Evolution of Research on Coordination Mechanisms in Multinational Corporations, in: *Journal of International Business Studies*, Vol. 20, No. 3, pp. 489-514.

## Case Study: McKinsey\*

### Profile and History

*McKinsey & Company, Inc.* is a global management consulting firm, headquartered in New York City, USA. The company belongs to its 1,200 partners, 400 of which are directors. Every three years, the directors elect a man-

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\* Sources used for this case study include the website <http://www.mckinsey.com>, various company reports and company presentations, as well as explicitly cited sources.

aging director to represent the company globally. Once a partner retires, the company withdraws his shares.

As of 2014, *McKinsey* has more than 100 local offices with equal rights in more than 50 countries. Between them, these offices speak over 120 languages and represent more than 100 nationalities. The firm serves as an adviser to businesses, governments and institutions and claims that over 80% of *Fortune's* list of the *Most Admired Companies* are among their clients. Between 2002 and 2014, *McKinsey* was ranked first on the “The Best Consulting Firms: Prestige” list on the *Vault.com* career intelligence website and was cited as the “most prestigious consulting firm of all” in a 2011 *New York Times* article. Being a private entity, the company does not publish many business figures. *Forbes* estimated their overall annual revenues at 7.8 billion USD in 2013 (*Forbes* 2014).

*McKinsey* is professionally organised into industry and functional practices. The practices are centres of competence that concentrate on one field. They are organised as a network and share their expertise with colleagues worldwide. In this way, *McKinsey* hopes to maintain a global and closely inter-linked web of functional expertise and industry knowledge.

In order to understand *McKinsey & Co.'s* coordination mechanisms and development, it is worth looking at their company history: The precursor of *McKinsey & Co* as it exists today was *James O. McKinsey & Company*, founded in Chicago in 1926 and named after its founder (see Bhidé 1996 for the company history and a comprehensive portrait). James O. McKinsey was a certified public accountant and professor of accounting at the University of Chicago. His company specialised in accounting and advising managers, which was called “managing engineering” at that time.

The entry of Marvin Bower into the company in 1933 was a milestone in the company’s development. After graduating from Harvard Law School in 1928, he had already gained experience at the prestigious law firm *Jones, Day*. Bower remembers his close cooperation with the company’s senior partner: “I made it an immediate objective to learn why it [*Jones, Day*] had been so successful. From observation and analysis during my *Jones, Day* years began the formulation of the program that I later brought with me to *McKinsey*.” The firm’s professional approach, recruiting standards and the prominence of its partners in charitable, social and cultural organisations left their mark on Bower. Therefore, he established all these elements years later at *McKinsey & Co* when he was in charge (Bhidé 1996, p. 8).

After James O. McKinsey’s sudden death at the end of 1937, the firm nearly disintegrated (Hill 2011). Extensive reorganisations and changes to the company structure in 1939 facilitated a prompt recovery. An essential contribution to the successful reorganisation of the company is attributed to Bower,

*Multinational Company*

*Origin and Precursor*

*Entry of Marvin Bower*

### Growth and Internationalisation

who was deputy manager of *McKinsey's* New York Office at that time. One central element was the focus on management consulting which had been moved to a single, central location in New York. Accounting was abandoned. The primary emphasis was now on solving major management problems. The services were based on high standards of integrity, professional ethics and technical intelligence. Bower's impact and his experience from his time at *Jones, Day* was also visible in the focus on human resources: The stated aim was to select, train and advance personnel so that the firm would be self-perpetuating (Bhidé 1996).

*McKinsey & Co* used the subsequent years to build the company's economic base. In the 1940s the company grew rapidly in the US home market in terms of both clients and offices. In 1944, *McKinsey & Co* opened their first office outside of New York, in San Francisco, and between 1947 and 1951 offices followed in Chicago, Los Angeles and Washington, DC. The first office outside of the US was opened in 1959 in London. In the following years the company transformed into an increasingly global consultancy, expanding into more than 50 countries. There was also enormous growth in the number of employees: *McKinsey* had only 15 consultants worldwide in 1933 and 80 in 1950, but they had 700 employees at the beginning of the 1980s. During the dotcom boom of the late 1990s, *McKinsey* grew significantly: Between 1994 and 2001, the number of consultants doubled from 3,300 to 7,700. This growth placed high demands on the management principles and the coordination mechanisms of the company, a demand which continues today.

### Management Principles

## Management Principles and the One Firm Principle

Even today, *McKinsey's* management principles are based on the goals that Bower and his partners set for the firm in 1939. The main goal was to build a firm that would continue in perpetuity. Foundation was the next principle, encouraging "every individual to protect and build the firm's future and reputation so that each generation of partners would pass the firm along to the next generation stronger than they had found it" (Bhidé 1996).

*McKinsey* states that the company's work is based in values that oblige them to meet the highest professional standards. "Client first" is the *primary principle of consulting*. This idea is followed to such an extent that *McKinsey* only accepts orders when the consultants are convinced they can usefully contribute to the solution of a major problem. Likewise, if a client is no longer satisfied and is not benefitting from the consultation as hoped, the cooperation can be terminated at any time.

A prerequisite for objective consulting is professional independence: the partners own *McKinsey's* working capital. Once a partner leaves the company, *McKinsey* takes back his shares. This is to ensure that only active partners in the company who are bound by the company's objectives have a vital interest in the business activity.

Strict secrecy of customer information is essential for trustworthy cooperation. The security of this trust in the long run is part of the *code of conduct* that every partner accepts when joining the company. There has, however, been one violation of the code of conduct: In 2011, Anil Kumar, a former *McKinsey* partner, admitted leaking information learnt from *McKinsey* clients while working for the firm (Hill 2011).

*McKinsey* views entrepreneurial challenges as an independent outsider and always from the perspective of the top management. Solution and implementation strategies are individually coordinated with the client's different needs, goals and company cultures – always in close cooperation with the client's top-level management.

Joining *McKinsey* as a consultant should provide individual development and be great career path if the consultant performs well. *McKinsey* has an integrated working atmosphere, free from any hierarchy. The company provides mentors, who assist the individual in his personal development, span his individual network and help him benefit from his colleagues' expertise. All consultants are expected to uphold the obligation to dissent, meaning that constructive criticism is explicitly encouraged and should be expressed.

*McKinsey's* global business activity is a daunting management challenge. The "client first" principle requires that every regional entity internalises the characteristics of the local market. At the same time, every local office and every consultant should share the same global company values.

*McKinsey* tries to balance these by using a strategy that Maister (1985) labelled the "*one firm principle*". Despite being embedded into the cultural characteristics of every region, the individual *McKinsey* offices form one common firm that shares its principles and values worldwide. This means the company is strongly decentralised. Every region acts independently as far as possible and makes independent decisions. In this way, the company can take regional markets and their characteristics into consideration. On the other hand, every consultant knows the values they must live by and the code of behaviour they must follow. Everyone is equally and intensively trained in these values and protocols. Everyone also knows that if an individual is in trouble, the group will expend every effort to help (Maister/Walker 2006).

*Warlord Model*

The opposite of the one-firm approach is what Maister/Walker (2006) call the *warlord model*. It encourages internal competition, individual entrepreneurship, distinct profit centres, decentralized decision making and the strength that comes from stimulating many diverse initiatives driven by relatively autonomous operators. In contrast, *McKinsey* expect each office to put the overall organisation's best interest before that of the office itself – a principle that is not compatible with warlord firms.

## Coordination Mechanisms

The one firm strategy at *McKinsey* is implemented via a number of coordination mechanisms. The following paragraphs used examples to list important formal and informal coordination mechanisms used by *McKinsey & Co.*

### Formal Coordination Mechanisms

#### *Decentralisation of Decision Making*

*McKinsey* is a decentralised organisation. To a great extent, management remains in the hands of the active partners, who are also *McKinsey's* shareholders and manage the company in a *consensus building* style. The individual regions, represented by the respective managing partners, act mostly independently; however, they are bound by the goals and values of the company. In this way, *McKinsey* can reduce the confusion that often accompanies growth by applying formal policies instead of *ad hoc* decisions.

#### *Partnership Committees*

The partners also preside over general affairs and the central control of the company. In order for these processes to be efficient, *McKinsey & Co.* established three committees in the 1950s: The *executive committee* was established to act for all of the partners on matters requiring more than a small group of people. The *planning committee* was formed to discuss important management questions and make recommendations to all the partners. Finally, the *profit-sharing committee* was formed to expedite the allocation to profits to the partners (Bhidé 1996). In practice, these committees have proven efficient even when many partners are involved. The decision making process takes longer but decisions are more likely to be accepted by firm members than if the leadership had acted unilaterally. This is another characteristic of the one-firm strategy.

#### *Recruitment Process*

Other important formal coordination mechanisms characterise the one-firm strategy. One central element is recruiting. As a one-firm company, *McKinsey* invests a significant amount of senior professional time in its recruitment process and tends to be much more selective than its competitors. As a *McKinsey* partner noted in the 1980s: "It's not just brains, not just present ability: you have to try and detect the potentially fully developed profes-

sional in the person, and not just look at what they are now. Some firms hire in a superficial way, relying on the up-or-out system to screen out the losers. We do have an up-or-out system, but we don't use it as a substitute for good recruiting practices" (Maister 1985, p. 8). This strategy is still applied today. Thus, to ensure that all entities follow the same values and goals despite the decentralised organisation, the company tends to "grow their own" professionals, rather than making significant use of lateral hiring of senior professionals. The young graduates are socialised during their time at *McKinsey* and internalise these values quicker than experienced consultants who only join *McKinsey* later in their careers.

*McKinsey* also adjusts financial incentives to the employee's coordination. Compensation systems (particularly for partners) are designed to encourage intrafirm cooperation and are based mostly on *group performance*, not individual performance. Promotions into a leading position require an associate to prove his long-term contribution to the firm and his impact to the team.

### Informal Coordination Mechanisms

*McKinsey* uses a number of mechanisms to coordinate the decentralised regional offices. The foundation of these mechanisms is the existence of shared values (see Table 10.2), which underpins sustained management effectiveness. The central goal is to establish extensive *intrafirm communication*, with broad use of consensus-building approaches.

*Compensation  
Mostly on Group  
Performance*

*Shared Values*

Table 10.2

## Shared Values at McKinsey &amp; Co.

<p><b>Put the client's interest ahead of our own</b> This means we deliver more value than expected. It doesn't mean doing whatever the client asks.</p>
<p><b>Behave as professionals</b> Uphold absolute integrity. Show respect to local custom and culture, as long as we don't compromise our integrity.</p>
<p><b>Keep our client information confidential</b> We don't reveal sensitive information. We don't promote our own good work. We focus on making our clients successful.</p>
<p><b>Tell the truth as we see it</b> We stay independent and able to disagree, regardless of the popularity of our views or their effect on our fees. We have the courage to invent and champion unconventional solutions to problems. We do this to help build internal support, get to real issues, and reach practical recommendations.</p>
<p><b>Deliver the best of our firm to every client as cost effectively as we can</b> We expect our people to spend clients' and our firm's resources as if their own resources were at stake</p>

Source: McKinsey 2014.

### Training

To achieve these goals, *McKinsey* invests in firm-wide training, both as a way to increase juniors' substantive skills and as an important group socialisation function. Part of this process is *McKinsey's* two-week training program for new professionals. The program is run by one or more of the firm's senior professionals, who spend a significant amount of time inculcating the firm's values by telling Marvin Bower stories. The program is specifically designed as a global training program that rotates between the countries where *McKinsey* has offices. This not only supports the one-firm approach but also has a dramatic effect on the young professionals' view of the firm.

Part of these informal mechanisms is imparting *company history*. All young professionals are given a copy of Marvin Bower's history of the firm, *Perspectives on McKinsey*, which unlike many professional firm histories, is full of philosophy and advice and low on historical facts (Maister 1985). The goal is that *McKinsey* employees internalise the company values and work together for the well-being of the company (in contrast to companies that emphasise individual entrepreneurialism, autonomous profit centres, internal competition and highly independent activities).

The criteria according to which new team members are chosen already fulfils this demand: *McKinsey* is looking for graduates that are not only smart, hardworking and ambitious but have also proven agreeable and able to work in a team. The goal is to prevent stardom. *McKinsey* members see

themselves as belonging to an institution that has an identity and existence of its own, above and beyond the individuals who happen currently to belong to it.

The principles that guide *employee behaviour* at *McKinsey & Company* are summarised in Table 10.3.

### Guiding Principles at McKinsey & Company

Table 10.3

We operate as one firm. We maintain consistently high standards for service and people so that we can always bring the best team of minds from around the world—with the broadest range of industry and functional experience—to bear on every engagement.

We come to better answers in teams than as individuals. So we do not compete against each other. Instead, we share a structured problem-solving approach, where all opinions and options are considered, researched, and analysed carefully before recommendations are made.

We give each other tireless support. We are fiercely dedicated to developing and coaching one another and our clients. Ours is a firm of leaders who want the freedom to do what they think is right.

Source: McKinsey 2014.

## Summary and Outlook

*McKinsey & Co* is a consulting firm that wants to keep the balance between a global perspective and local activities. An essential part of coordinating the independent regional entities is the one-firm strategy. This is based on the idea that the company's partners should take essential decisions together and by consensus, that the company's values are more important than short-term success and that the team is more important than individual success.

Maister/Walker (2006, p. 2) summarise the elements of the one-firm approach as follows:

- highly selective recruitment
- a “grow your own” people strategy as opposed to heavy use of laterals, growing only as fast as people can be developed and assimilated
- intensive use of training as a socialisation process
- rejection of a “star system” and related individualistic behaviour
- avoidance of mergers, in order to sustain the collaborative culture

- selective choice of services and markets, winning significant investments in focused areas rather than many small initiatives
- active outplacement and alumni management, so those who leave remain loyal to the firm
- compensation based mostly on group performance, not individual performance
- high investments in research and development
- extensive intrafirm communication, with broad use of consensus-building approaches.

This approach is supported by *organic growth* of these values in the company history. This leads to a strong culture and clear principles. Because all employees at *McKinsey* follow the same values and strive toward the same goals, every regional entity can act autonomously without fragmenting the global *McKinsey* network.

Nevertheless, a decentralised organisation depends on individual decision-makers. The formal and informal coordination mechanisms have not always been able to keep up, particularly during the dotcom boom and the associated company growth. Therefore, even at *McKinsey* individual executives have taken advantage of their decision making powers and acted in their personal interests instead the company's (e.g. the case of Anil Kumar, mentioned above). Paul Friga, who worked at *McKinsey* in the late 1990s and now lectures on consulting at the University of North Carolina's Kenan-Flagler business school, asks one key question that *McKinsey* needs to answer in the future: "How do you maintain quality with growth?"

## Questions

1. What is the one-firm principle? What are the advantages and disadvantages of this strategy? (Discuss the company's owner structure and the role of decentralisation in the organisation of the *McKinsey* entities.)
2. What role do partners play in coordinating the regional entities of the company?
3. Why do recruiting and personnel management play such a central role in the *McKinsey*'s management? What is the employee's role in implementing the formal and informal coordination mechanisms.

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