

## Impact of Decentralized Decision Making on Firm's Performance

Bashir S\*

Bahauddin Zakaria University Multan, Pakistan

### Abstract

Today firm's especially large one can't be controlled and administered by single individual and if so, the performance of those firms is not as good as the decentralized firms. Now a day's firm gives opportunity to each employee to participate in decision making and give them freedom to make their own decisions in favor of firm. We take the examples of Honey Well, Google, Toyota and different sectors of Pakistan. We also give a model of our study that explains how decentralization increases performance with the help of cooperation. The result of study is that the performance of firms increases as the decentralization increases.

**Keywords:** Decentralization; Firm's performance; Decision making; Pakistan

### Introduction

In all companies on nearly all levels everybody participates with decisions, small or big ones. This is every day job of nearly every employee. Now every day job needs thinking about it, and decisions on most company levels. Decision has some categories like strategic decisions management control etc. Some decisions are made by following certain forms are called structured decisions. Some decisions are not structured basically for complex situations. Decisions made by different persons are of different persons are of different types and only one information system cannot support all requests. Decision process is independent from decision types. Several management perspectives exist in which manager has to act during decision making are technical rational perspective, behavior and cognitive. When trying to make a good decision, a person must weigh the positives and negatives of each option, and consider all the alternatives. For effective decision making, a person must be able to forecast the outcome of each option as well, and based on all these items, determine which option is the best for that particular situation.

A decision which is made by all level of employees, i.e., top, middle or lower level, will increase the performance of the organization because the lower level of employee know very well regarding the ground realities and critical situations of the organization regarding operational aspects of the organization. A decentralized decision is a decision which is taken by considering the view points, participation and power of decision making of all level of employees. Almost all organization made decentralized decisions to some extent but they limit the authority and power of employees. An organization in which employee at lowest level make decisions is a highly decentralized organization and this happened in extreme cases.

The degrees to which lower level employees provide input or actually make decision. The organizations have had to become more flexible and responsive; there is distinct trend toward decentralizing decision making. In large companies especially lower level managers are "closer to the action" and typically have more detailed knowledge about problems and how best them than do top managers. For example at Terex Corporation CEO RON Defoe, big proponent of decentralized management, He told his managers "You Got a run the company you're given." And they have! The company generated

revenues of \$6.4 billion in 2005 with a little over 1500 employees worldwide and a corporate head quarter staff of 66 people.

Another example at Honey Well specific which moved from a hierarchical management structure to one that is much flatter and team based. Before the change all decisions were made at headquarters. So the result was increased revenues and more intimate knowledge of company's major customer. Likewise the bank of Montreal's some 1100 branches was organized into 236 communities-group of branches within a limited geographical area. Each community is led by area manager. This area manager responds faster and works better than senior executive.

Toyota also use decentralized decision making process. It gave every employees the skill the tools, the permission to solve problems as they arose and to head off new problem s they accrued. After many years now Toyota gets more output and desirable results than its competitor. Google is also following the decentralized decision making process to enhance the productivity of its employees. Now Google is world famous company because of its involvement of all managerial levels in the decision making.

In decentralized decision process the employees try to give their best the efficiency and effectiveness of their work increase. The decentralized decision rights have very strong impact on IT performance of firms. The firms change their decision making structure from centralized to decentralized so the productivity effect can be seen. The productivity and performance of the firms can be increased. Basically decentralized decision making is a process in which employee involvement is more and this can be happened in small, medium or large level of organization. Decentralized decision making also give chance to lower level employees to contribute their suggestion and recommendation, which is almost neglected in vice versa cases, and show their capabilities for the growth of process and as well as for the increase in the profit. Sometime due to decentralized decision making lower level of employees make such a huge profits, which is not expected from them but this happens just because of delegating the authorities and

\*Corresponding author: Bashir S, MS Finance, Bahauddin Zakaria University Multan, Pakistan, Tel: 0092-332-6158448; E-mail: [Sikandar.basheer@yahoo.com](mailto:Sikandar.basheer@yahoo.com)

Received May 15, 2015; Accepted May 27, 2015; Published June 08, 2015

Citation: Bashir S (2015) Impact of Decentralized Decision Making on Firm's Performance. Arabian J Bus Manag Review 5: 135. doi:10.4172/2223-5833.1000135

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giving power to lower level and all employees for making decisions. As results shows that decentralized are the main causes of quality products with greater productivity and with increased sales. If we give decision making power to our all employees working in a manufacturing firm, then the performance of all departments and employee will be high in productivity, quality and sales.

Studies also compare the results of those firms which were using centralized decision making at their inception and they were habitual to use decentralized decision making later on. The results were totally different. For example Nestle, a Swiss base multinational corporation, having their business almost in all countries of the world used decentralized decision method in each country according to needs, wants of customer. Another benefit of decentralized decision making is that the 'Decision Making Authority is always on the spot, there is no wastage of time and Opportunity' as employee has power to make decision, they can make their best decisions according to situation and need of hour in consideration with organization policy and procedure in the best interest of the company.

### Importance of Study

Large firms have large setup and having more employees comparing with small and medium level organizations. A Manager is not available every time on each station. Definitely he/she has many other tasks as well. If an employee at lower level is given authority to make decision then he/she can make their best decision on the time. No doubt there are some employees who make decisions in their personal interests which are contrast to organizational goals and objective, but the benefits of decentralized decision making is more as compared with its cons. The timely decisions made by employees are more beneficial as compared with "Waiting for a Decision Making Authority" to make decisions. Decentralized decision making also increase and point out the capability and confidence of employees to understand and cope with critical situations. Decentralization also decreases the burden of top level employees of the organization and their focus in just to make future growth decisions regarding the firm's.

### Literature Review

Seemab [1] finds that decentralization is central theme of new public management and pursued by the developing countries under the domestic pressure of influence of IMF as wider strategy for achieving good governance. Efficiency is not the only concern of public sector reforms; it also encompasses the ideas of democratic participation, accountability and empowerment. Decentralization reforms in the public sector are mainly viewed as a mean to attain service delivery responsiveness and effectiveness. However the assumption that decentralization service delivery arrangement would lead to better performance has only yielded partial support. Decentralization was achieved by developing political power, decentralizing administrative and financial authority to accountable local government for good governance, effective service delivery and decision making through participation of people at the grass root level. District Administration, Tehsil Municipal Administration and Union Administration are three tiers of local government. With respect to the improvement in community participation in service provision, it was found that it has been significantly improved after decentralization reforms. Under the City District Government, there are less financial constrains than before decentralization.

Romana and Canals [2] use loan-level data to study how the organizational structure of banks impacts small business lending. They

find that decentralized banks where branch managers have greater autonomy over lending decisions give larger loans to small firms and those with soft information. However, decentralized banks are also more responsive to their own competitive environment. They are more likely to expand credit when faced with competition but also cherry pick customers and restrict credit when they have market power. This darker side to decentralized banks in concentrated markets highlights that the level of local banking competition is key to determining which organizational structure provides better lending terms for small businesses.

Abbasi Aliya [3] addressed reasons for stagnant economy as depressed consumer credit market, slow process of public sector programming, reduced subsidies, security threats, instability and energy risk. Good results of agriculture sector are due to good weather conditions. Political and social environment of Pakistan is unstable with stagnant economy and dictatorship. Organizational structure of the Board of investment is that the president is the head of the state and the federal minister is the in charge having 27 members of which seven are from government and twenty are the representatives from the private departments. It is a decision making authority and also a clearing house that accepts different proposals and problems by industries. It reveals and proposes the investment strategies and monetary or fiscal policy is also made by the BOI. Government places funds for BOI and it has to submit the annual report to the government at the end of each fiscal year.

Zoe Scott [4] conducted this analytical review; it explores the link between decentralization and service delivery, economic development and social cohesion. He also identify the factor that effect decentralization. He included the review from various academic journals, donors report and empirical case studies from Asia, Africa and Latin America. Policy implications can be found at the end of each section outlining key issues in the decentralization, how decentralization reforms could be designed to improve local development and social cohesion. Decentralization exists in three forms; Financial, administrative and political. Majority of paper include review of political decentralization. It is difficult to research when economic development linked with decentralization due to lack of reliable data. Decentralization is not a panacea. It cannot cure all the ills of developing countries in the terms of poor service delivery, weak economic development, low social cohesion and high level of conflict. Decentralization cannot take place in political vacuum. Many claims are made in favor of decentralization. Much of literature and evidence centers on the intrinsic value of decentralization as a desirable goal in its own right. There are very few cases where equity and efficiency outcomes have improved as a result of decentralization. The main impression gained from decentralization is, it has done little to improve the quantity, quality or equity of public services in the region. It is difficult to link economic development with decentralization. It is difficult enough to ascertain how decentralization has impact on economic growth; no consistent empirical patterns emerge from these studies. They also conclude that decentralization has not carried out effectively in either country although they are both experiencing strong economic growth. Decentralization possibly can be beneficial for local government by limited tools. Social cohesion reduces the conflict, ethnic tension and inequality of wealth and of political participation.

Chmicelson Institute, Burgeon, Norway [5] conducted a research on the implementation of decentralization reforms in the health sector of Tanzania started in the 1980s. These reforms were intended to relinquish substantial powers and resources to districts to improve the development of the health sector. Little is known about the impact of

decentralization on recruitment and distribution of health workers at the district level. Reported difficulties in recruiting health workers to remote districts led the Government of Tanzania to partly re-instate central recruitment of health workers in 2006. This study highlights the experiences and challenges associated with decentralization and the partial re-centralization in relation to the recruitment and distribution of health workers. The study has shown that recruitment of health workers under a centralized arrangement has not only been characterized by complex procedures, but by severe delays and sometimes failure to get the required health workers. The study also revealed that recruitment of highly skilled health workers under centralized arrangements may be both very difficult and expensive. Decentralized recruitment was perceived to be more effective in improving retention and retention of workers within the districts.

Uchimura and Jutting [6] say that Fiscal decentralization has become a worldwide trend. The literature indicates that transferring authority and resources from central to local tiers of government brings allocated benefits for the provision of local public goods. China is very interesting case study for testing whether fiscal decentralization leads to improved production of local goods and services. That impact is assessed on health sector panel data analysis using country level data to estimate the impact of fiscal decentralization on health outcomes. This paper supports that fiscal decentralization brings more efficient production of local public goods government should estimate risk and benefit of this decentralization and there must be proper implementation.

Naeem, Iftikhar and Jangraiz [7] concluded that decentralization is an important weapon to achieve economic growth. It helps smaller units of federation to take part in the economic development of country and provide opportunity to government to complete the goal more efficiently. They concluded that resource distribution mechanism of Pakistan failed to positively influence economic growth of the country in long run. Decentralization helps to be more and more innovative, responsible and efficient. It brings up the true potential of a locality with the efficient resource exploration and its efficient utilization. On its positive achievements, national finance commission has a best system ensure resource distribution as it takes all decision makers on board and decides over resource distribution with their consent. More financial autonomy was delegated to the provinces. However, decentralization also has some negative points, such as in political economy like Pakistan all provinces have differing characteristics and offer different economic opportunities to its people. Key to successful public service delivery is adequacy, sufficiency, transparency and regular flow of funds; this should be accompanied with clearly identified aims and objectives of financing and service delivery assignment.

This paper women power in decision making [8] of the platform for action focuses on achieving effective participation by women in decision making in elected bodies the judiciary and civil society. The platform has two strategic objectives. First take measure to ensure women's access to and full participation in power structures and decision making. Second, increase women's capacity to participate in decision making. The commission on the status of women continued to pay attention to the issue and adopted agreed conclusion on women and decision making processes in 1997 and 2006. So that women's participation in political process and parliament has become important since 1995. Most nations also adopt this thing give participation in important entities. With the passage of time some developments are made in this platform, women's share in public and private sector in managerial positions increase. They also ensure that women involve in decision making also have expertise and qualification.

Peterson [9] said that Pakistan has taken initiative in decentralization and make rapid progress. Local Government ordinance created local Government entities. High quality, more efficient delivery of basic service and greater accountability of local government were the main objectives. Uncertain role of provinces, governance and citizen community board and service delivery assignments were the dimensions of decentralization. Tehsil Government and District Government performed their role very well. Fiscal decentralization is the heart of any devolution exercise, without fiscal decentralization no authority is devolved. District and Tehsils would have had to prepare separate development and non-development budgets for each of the provincial funds. Local urban government appear to have available to them tax and revenue instrument that could go far toward generating additional own source revenue. They could establish a policy of full cost recovery for basic service delivery or they could adjust fee schedules so that poor households don't pay the full costs, while middle income households and commercial operator do, with targeted subsidies for poor households. This adjustments would both rise own source revenues and establish a clear connection between service cost and service delivery. Strengthen basic service delivery, involve collaboration of urban local government with the provincial government are some opportunities for World Bank involvement.

Anwar [10] concluded that the privatization in Pakistan for policy making is traced back since 1950 when in 1952 there is the development of industrial sector. These units were moved from public to private sectors. But nationalization in first half of 70's which has adverse effects on economy were reversed in 1977 and privatization becomes an important instrument of economic policy. In 1978 when there is declaration of transfer of managed establishment order then the former owners have given the preemptive right to purchase that firm otherwise the government is free to transfer to any party. In 1985 there is development of cabinet disinvestment committee which consists of minister of finance, production and industries. For it rules and procedures have been made and positive development takes place during that period, but is remained unimpressive due to inadequate legal, political and institutional framework which affects the process of transferring state owned enterprises. In 1991 there is further step is taken towards privatization by the development of Privatize commission. Some legal actions also taken in privatization in which the policies of golden hand shake and volunteer separation scheme in which workers have been given the benefit of one plus four salaries.

Haque [11] concluded as decantation, delegation, intermediation and privatization. People engaged in the decentralization must have clear idea about the decentralization. Privatization was concluded by Bretton wood management institute of global economy as the type of decentralization but here power sharing aspect of decentralization is missing. Studies have been done to gain the experience of the decentralization, relationship between the local level development and decentralization is causal. Development is not possible without the decentralization but there must be proper resources and the unit to whom the authority is delegated must be competent. Further exploration about the participation in development prevails and either it is a myth or in reality. Some argued that Bureaucracy in participation is actually a reluctant factor because everybody believes that it is a good method of decision making. Actual participation is not fully possible because local level staff that interacts with citizen to allow them to take part actively in decision making to remove the restraints imposed by the center [12].

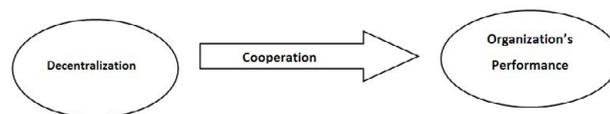
About the possibility of the participation Oyogi Walter [13] concluded that power can be shared if someone doesn't need it more, in pressure, sustainability is difficult. For appropriate settings for decentralization there is direct relationship between popular participation and decentralization. Participation is possible when government is motivated to delegate power to the lower levels or local communities at regular basis. Possible strategies for involving people in decision making is self-help community development ,admin reforms to access condition, coalition between people and officials of the state. A good model must be means a structure of allocating powers between center and localities which will give to the canter and localities a balance in powers. But it could be an evolutionary process rather than revolutionary.

Efficiency of the public sector is not sufficient Dr. Sultan khan argued that bureaucracy restricts the decentralization of powers and bureaucrats have more power during the period of instability. (Mushfiq Ahmed-daily times) economic progress during the Musharaf regime was due to national and international sector environment and US has played greater role to upward the economy of Pakistan to a record export from a collapse by lowering the burden of the solid debts. Environmental factor effects the public sector because it has a large corruption prevails in bureaucracy and political influence in appointments, scarcity of resources, low salaries of government servants. Reasons for corruption are low salaries of the government servants, pensions and inadequate welfare programs, low accountability. Burden of economy of the civil servants and one civil servant is to manage the 67 people 110 in India. There is huge gape of FDI But investors have a threat of nationalization and liberalization also a great gap prevails between policy making and its implementation.

Muhammad Saleem [12] conducted the comparative analysis of 21electricity generation plants (12 private and 9 public) using panel data of 6 years using two state-of-the art methodologies: Stochastic Frontier Analysis (SFA) and Data Envelopment Analysis (DEA). These two method measure the efficiency of the firms. The result shows a mixed technical and scale efficiency scores for the public and private generation plants. Result also suggests that public ownership has a negative impact on the technical efficiency of the firms. Private plants have less variation and more managerial efficient than public firms. Public firms consider private firms as their Benchmark. From last two decades most of the developing countries like India, Pakistan started the reforms in electricity sector. The main objective of these reforms was to shift the ownership from state owned and centralized organization of infrastructure to private ownership. The reasons for this shifting of ownership were the burden of price, subsidies, low service quality, low collection rates, high network losses, and poor service coverage. The reforms have sought to transform the state-owned and centralized electricity sector into decentralized. There is a lack of theoretical and empirical analysis in predicting what type of reform will best suit the developing countries like Pakistan and whether there is any way to avoid the costly regulation for the sector. This paper aims to test the null hypothesis of existence of technical efficiency in publicly owned firms. The joint use of parametric and non-parametric approaches can improve the results. The electricity is the main engine for economic activities and industrial growth. Reliable, secure and cheaper electricity supply is needed for commercial activities. It has the main three subsections namely generation, transmission and distribution. In the developing countries, it is the main source of employment, revenue for the government.

Before 1980s, it was considered as a public sector natural monopoly. In spite of this there may have cost of cost of poor planning, which is paid by the customers in the form of higher tariff rates and poor quality of service. Political intervention, high system losses and poor collection of bills are the major drawback in this sector. GOP (Government of Pakistan) realized the situation and pressure from international donor agencies (IMF, World Bank and ADB) and started the reform in this sector. GOP has introduced policies for power generation. In the 1<sup>st</sup> power policy, private electricity generation was allowed. So, mostly private plants started their production after 1995 and quite new in technology and experience as compared to the public generation plants. There are identifiable technical inefficiencies in electricity generation. It invites further reforms, competition and a suitable regulation in this sector.

### Model Specification



There are three variables. We take Decentralization as independent variable, organization performance as a dependent variable and cooperation as a mediating variable. As firms delegate decision making authority to the employees, the organization performance increases. There is a positive relationship between decentralization and organization performance. The cooperation plays an important role in the organization performance, if cooperation will increase between the top level management and employees at lower level the organization performance enhance.

### Research Methodology

This study checks the importance of the relationship of decentralization and organization performance. This is a very important study because firms now a day are conscious regarding their performance. Due to decentralization, performance of organization is changing day by day and affecting the cash flows of the firms. Due to changes in cash flows the value of the firm may also being affected. The purpose of this research is to examine the performance of organizations over the period 1997 to 2011.

### Results and Discussion

Top management is relieved of much day-to-day problem solving and is left free to concentrate on strategy, on higher level decision making, and coordinating activities. Decentralization provides lower level managers with vital experience in making decisions. Without such experience, they would be ill-prepared to make decisions when they are promoted into higher level positions. Added responsibility and decision making authority often result in increased job satisfaction. Responsibility and the authority, that goes with it makes the job more interesting and provides greater incentives for people to put out their best efforts. Lower level managers generally have more detailed and up to date information about local conditions than top managers. Therefore the decisions of lower level management are often based on better information. It is difficult to evaluate a manager's performance if the manager is not given much latitude in what he or she can do. Lower level managers may make decisions without fully understanding the "big picture." While top level managers typically have less detailed information about local operations than the lower level managers, they usually have more information about the company as a whole and

should have a better understanding of the company's strategy. In a truly decentralized organization, there may be a lack of coordination among autonomous managers. This problem can be reduced by clearly defining the company's strategy and communicating it effectively throughout the organization. Lower-level managers may have objectives that are different from the objectives of the entire organization. For example, some managers may be more interested in increasing the sizes of their departments than in increasing the profits of the company. To some degree, this problem can be overcome by designing performance evaluation system that motivates managers to make decisions that are in the best interests of the organization. In a strongly decentralized organization, it may be more difficult to effectively spread innovative ideas. Someone in one part of the organization may have a traffic idea that would benefit other parts of the organizations, but without strong central direction the idea may not be shared with, and adopted by other parts.

## Conclusion

We have studied the organization of different countries in which we find that the ultimate performance of the firms increases with the decentralization. As the communication and cooperation of the top level management with middle and lower level management increases, the organization performance increase. We conclude that the cooperation of top level management with lower level management is much more important. Majority of the organization have experiences and well educated Top level management that consider the importance of decentralized decision making and they consider their employee as an asset and they take the opinion of their employees while making decision, the management is called cooperative management, however in some organization the management consider the staff as illiterate, inexperience so they don't even think to involve their staff for decision making, if the element of cooperation exist in the management then

they will consider they employee opinion and they will give respect to the opinion of their employees and vice versa. If the Management is cooperative, employee will feel respect for themselves and they work hard for the betterment and prosperity of the organization and if the management is not cooperative and they did not give authority to make decision by employees or not consider the opinion of their employee then definitely the organization performance will move downward.

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