



Organization of Multinational Operations

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In this chapter, we present the various organizational structures of MNCs, and we will learn about the many factors that influence an MNC's selection of the proper organizational structure. Some of these factors are external forces and demands, such as economic conditions at home and abroad, host government policies, product-market characteristics, and information technology. Factors related to the firm itself are the history of the company, top management philosophy, nationality, corporate strategy, and degree of internationalization. We first discuss the development of an organizational structure designed to deal with the export of products to foreign markets. The subsequent major structural designs for MNCs, including the autonomous foreign subsidiary, the international division, the geographic and product divisions, and the matrix structure, are explained in this chapter. Finally, we describe the newer forms of organization, such as market-based and strategic business unit organizations, virtual corporations, and networks.

Overview

Chapter Vignette

Born Global Internationalization used to be incremental expansion and a learning process for firms going through the successive stages of domestic, international, multinational, and global design and restructuring. Now, this norm is being revised. The unique feature of the global economy, which is dominated by the interlink between firms in the value chain covering R&D, production, logistics, marketing, and financial service, enables these firms to start from the beginning on a global mission. These firms are “Born Globals.” [43] Born Globals can be defined as “Business organizations that, from or near their founding, seek superior international business performance from the application of knowledge-based resources to the sale of outputs in multiple countries.” [44]

An example of a **Born Global** company is CMS Energy, which was a relatively small Midwest utilities firm generating electric power for the state of Michigan. In the 1990s, under the new management, it began transformation into global operation at a very fast pace. Within a decade, it became one of the leading companies in the world for building and operating the systems that bring energy to people. It operates worldwide businesses in energy and power production, in natural gas pipelines and storage, and in oil and gas exploration and production. It also builds and operates power plants, power lines, and distribution companies. It provides energy marketing and management services. CMS Energy has acquired assets totaling around \$16 billion throughout the United States and in 22 countries around the world. It generates revenues worth more than \$10 billion. It has achieved this phenomenal growth and globalization in less than a decade [1, 2].

Introduction

Collective endeavors, such as businesses, require a certain amount of order and organization, without which failure ensues. Organizational goal achievement depends on the effective combination of the contributions and work output of individual members. Because organizational activities are interdependent, complementary, and varied in type and timing, they require a certain degree of coordination and integration, which are facilitated through their operational proximity. Operational proximity means making allowances for the synchronization of activities in time and space. Simply put, physical proximity allows members of the organization to perform their tasks together and in a timely fashion. Organizational activities need to be grouped in a way that makes it easy for people to work together and expedites progress toward goals. Different methods and frameworks are used to arrange the operational proximity of organizational activities and tasks. The methods of organizing are based on the work specialization, division of labor, and economies of scale, principles that were first articulated by Adam Smith. The frameworks used should provide for appropriate job designs, reporting and communication arrangements, authority and responsibility distribution, and the physical layout of the organization. In short, an organization needs form and structure.

Definition and Functions of Organizing

The organizing function involves designing a skeleton and structure that delineate the nature and extent of formal relationships among various internal components, including tasks, jobs, positions, and units of the organization. It is the physical and nonphysical form the organization assumes in response to its internal requirements and external environment. It allows for the distribution of power and authority among the members and the establishment of communication lines between them. The internal requirements of a firm are related to the type of technology used, the nature of tasks performed, and the type of strategy employed. The external environment is the combination of outside constituencies and forces that are influential in determining the fate of the organization. Because firms have different internal requirements and external environments, they employ various structural configurations. In other words, the structure of a firm is a tool for attainment of goals and a means to an end.

The structure of the organization defines the boundaries of the organizational components (units); the relationships among the various parts; the extent, limits, and location of authority and power; and the formal communication patterns. The architects of the organizational structure need to answer four basic questions about the firm [3, p. 529]:

1. What should the units of organization be?
2. Which components should be joined, and which should be kept apart?
3. What size and shape pertain to the different components?
4. What is the appropriate placement of and relationship between the different units?

The basic principle for organizing is to group activities that have similar characteristics and functions from the lowest levels of the firm and proceed upward. In doing so, tasks are clustered into jobs, jobs are combined to form departments, and departments are put together to create business units. Larger firms that serve multiple markets and have many product lines, consequently, have a number of different business units. These business units are organized into a corporate structure. The clustering of activities just described is commonly referred to as *departmentalization*.

There are six common bases for departmentalization or grouping of organizational activities: knowledge and skill, work process and function, time (shifts in a factory), output (products), client, and place (geographic) [4]. Figure 8.1 represents organizational structures resulting from two of the most commonly used types of departmentalization: functional and geographic.

The relationships provided by the operational necessities that we have just described are basically internally oriented. These relationships are mediated by the strategic requirements that are dictated by the nature of the competitive forces that govern the external relationships. Organizational structure is often determined by both internal requirements and external forces. However, from time to time, one element, either internal or external, exerts more influence on the shape of the organization.

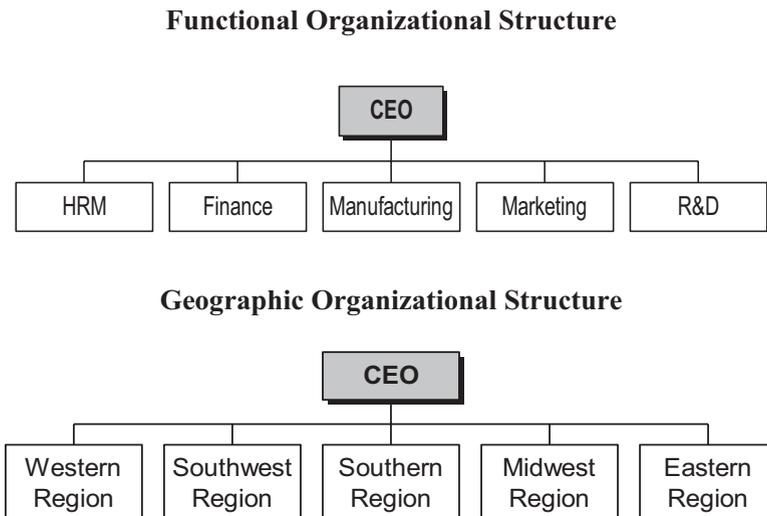


Fig. 8.1 Two types of departmentalization

The Organization of Multinationals

The fundamental structural considerations of MNCs are similar to those of domestic firms. Internal requirements and the external environment of MNCs, however, pose additional design challenges. The MNC structure should take into account physical distance, legal and governmental considerations, headquarter-subsidiary relationships, and many other factors. Because of the environmental diversity, the coordination and integration needs of MNCs are different from those of domestic firms. Therefore, the requirements of operating across national borders create additional concerns for organizing. In addition to those issues pertinent to organizing in domestic firms, there are three major concerns in the design of an MNC organizational structure [5, p. 5]:

1. How to encourage a predominantly domestic organization to take full advantage of the growth opportunities abroad
2. How to blend product knowledge and geographic area knowledge most efficiently in coordinating worldwide business
3. How to coordinate the activities of foreign units in many countries while permitting each to retain its own identity

As consumers' tastes converge globally, the firms that respond to this convergence in product preferences could gain competitive advantage. MNCs respond to these changes by adopting the various strategies that were discussed in the previous chapter. Therefore, we could add another item to the above list:

4. How to exhibit local responsiveness while maintaining a global orientation

An MNC's response to these concerns is influenced by many factors, including the size and history of the company, top management orientation, product-market characteristics, and corporate strategy. As MNCs expand abroad, under the influence of these factors, their structures evolve to facilitate the accomplishment of corporate objectives. Consequently, there are many variations among MNC structures.

The organizing variations among firms are usually at a level directly below the chief executive officer. That is why we focus our presentation at this level. We also confine our discussion to the managerial organization, as opposed to statutory or legal organization. To satisfy host countries' legal and statutory requirements, MNCs create legal entities that exist on paper only. The statutory entities are designed to fulfill legal obligations while promoting the MNCs' objectives of ease of operation and increased earnings. It is through these entities that the legal and ownership relationships between the headquarters and its various subsidiaries are specified. Many different statutory and legal forms link the parent company to its foreign operations, including branch offices, subsidiaries, and holding companies. The legal requirements of the host country and tax implications determine the MNC's statutory organization [6, p. 253].

Factors Influencing the Structure of MNCs

Many factors influence an MNC's choice of organizational structure: external environmental forces, factors related to the firm itself, or a combination of both.

External Forces

The major external environmental forces that influence an MNC's structure are economic conditions, host governments, technological developments, product-market characteristics, and information technology (see Ref. [7, Chaps. 3 and 8, pp. 97–99]).

Economic Conditions Changes in economic conditions at home and abroad create opportunities for and threats to the operation of MNCs. Unemployment and reduced purchasing power resulting from recessions and slower economic growth force adjustments in MNCs' business operations. Reduced market share and earnings in mature markets may prompt firms to diversify. Internationalization may partly be the consequence of home market saturation and maturity.

Technological Developments In some industries, the high level of risk and huge investment required for developing new products are straining the financial capabilities of many MNCs, prompting international joint ventures between competitors. Also, because of globalization, MNCs face the same competitors in many markets. Consequently, local advantages are quickly eroded by the immediate responses of international rivals. The reality of competition between partners of international joint ventures and the need for fast response require a flexible structure and a closer integration of worldwide operations.

Technological developments are considered to be the most important factor influencing structural changes in MNCs. New product development and new manufacturing methods offer opportunities for expansion into new markets. In turn, expanded foreign operations resulting from technological advances necessitate the provision of organizational support systems and structural changes. Technological advances have increased international competition and caused the global integration of MNCs. Telecommunications and information processing technology have improved the ability of the headquarters office to monitor the performance of subsidiaries in a timely fashion. Improved communication between subsidiaries and headquarters allows the adoption of either a centralized or a decentralized mode of control. In either case, the management of information provides an opportunity to devise a proper structure.

Product-Market Characteristics Newly industrialized countries such as South Korea and Taiwan have appeared on the international scene as competitors partly because of recent shifts in regional economic growth. The emergence of this new

competition has increased market uncertainty and instability. Simultaneously, advances in manufacturing technologies, new product development, and marketing, along with the convergence of consumer tastes and preferences for certain products, have created a global market. To compete in this market, MNCs need global economies of scale and quick response. Consequently, firms require a greater degree of internal integration and coordination among their dispersed worldwide operations while allowing for local responsiveness to their national subsidiaries. Therefore, in designing a new structure, MNCs are concerned with the reconciliation of these two conflicting needs. An MNC's organizational structure should facilitate global integration and local responsiveness. Other product-market characteristics, such as diversity of product line and the nature of the competition, affect the organizing efforts of MNCs. A product division structure and a centralized decision-making process, for example, would serve well those firms that have a diverse product line and are competing with other MNCs in national markets. If competition in national markets is limited to local firms, granting more autonomy to the subsidiary would be appropriate. With competition limited to local firms, intimate knowledge of local conditions and a closer relationship with domestic businesses would be necessary.

Host Government Policies Host government policies are influential factors shaping the strategies and, in turn, the structure of MNCs. Investment incentives offered by host governments stimulate FDI and the expansion of MNC operations. Many forms of trade and business requirements and restrictions influence the management of MNCs. Taxes and tariffs, the need for local content, local ownership, technology transfer, local employment, and minimum exports exert pressure on foreign subsidiaries. Of course, an MNC's responses to host government policies influence headquarters-subsidiaries relationships and subsequently result in structural changes.

Company Factors

Major company factors include its history, top management philosophy, nationality, corporate strategy, and degree of internationalization (see Ref. [7, Chaps. 3 and 8, pp. 97–99]).

Company History Firms in the early stages of internationalization have a few managers with experience and expertise in coping with a complex worldwide operation. As the firms continue to operate abroad and learn how to manage their worldwide businesses, decisions regarding the organizational structure will be affected by those years of experience in foreign markets. Therefore, when there is a small pool of managers with international experience, the most feasible structure is an international division. The use of other types of structures has to wait for more advanced stages of internationalization.

Top Management Philosophy Top management philosophy regarding the autonomy granted to subsidiaries is reflected in various control mechanisms that the headquarters employs. The organizational structure is a means for exercising headquarters control over subsidiaries. A loose federation of national subsidiaries under the general direction of headquarters, for example, is a sign of management belief that local executives are better qualified to run their own operations.

Nationality There are differences among the organizational designs of American, Japanese, and European MNCs. European subsidiaries, for example, tend to have more autonomy than American subsidiaries. The type of control used also varies among the MNCs of different countries. US MNCs tend to exercise a higher level of output control over their subsidiaries, while Europeans usually exert a higher level of behavioral control [9]. Foreign subsidiaries of Japanese MNCs appear to have more local decision-making power. Executive selection, socialization, and acculturation of Japanese managers ensure the subsidiaries' strict compliance with the norms set by headquarters, reducing the need for other control mechanisms. Consequently, there is no need for foreign subsidiaries of Japanese MNCs to send extensive and frequent performance data to their headquarters like American subsidiaries are required to do. Another unique feature of Japanese MNCs is the structure of the *keiretsu* system. A *keiretsu* is a tight network of companies that share capital, R&D, customers, vendors, and distributions. *Keiretsus* are the intricate web of relationships linking banks, manufacturers, suppliers, and distributors with the government. Major *keiretsus* have the ability to control nearly every aspect of the value chain in a variety of industrial, service, and resource sectors. Many Japanese manufacturing firms have been using the *keiretsu* system. The Japanese have effectively used *keiretsu* systems to gain international competitiveness and successfully penetrate world markets.

Corporate Culture Another factor that influences the choice of organizational structure is corporate culture. Trompenaars and Hampden-Turner [10, p. 167] identified four types of corporate culture: the family, the Eiffel Tower, the guided missile, and the incubator. These were discussed in the chapter on culture (Chap. 3). Of course, corporate culture is a product of the national culture in which it operates. Therefore, these four types reflect the overall characteristics of their respective national cultures. Trompenaars and Hampden-Turner suggested the appropriateness of certain kinds of organizational structure for each corporate culture type. For example, matrix organizational structure may run into implementation problems in Asian countries, because, in these countries, a family corporate culture is a dominant form. In such a corporate culture, employees cannot give their undivided loyalty to two bosses. Superiors are regarded as fathers, and no one can have two fathers.

Corporate Strategy Corporate strategy greatly influences the firm's structure. From the pioneering work of Chandler [11], and subsequent research by others [12], we have learned that the strategy of the firm sets the stage for structuring the

organization. The popular phrase “structure follows strategy” suggests the link between the two. An internationalization strategy that moves the firm away from the familiar domestic market also results in structural variations. Some organizational structures employed by MNCs appear to work better with certain strategies [13, 14]. For example, international division structure tends to fit a strategy that calls for a low level of foreign sales with a few products. Strategies that involve product diversity tend to be associated with product division structures.

Organizational Structure: Japanese Style

Like many other aspects of the Japanese economy, politics, and culture, there is a unique Japanese organizational form called *keiretsu*. *Keiretsus* are the outgrowth of *zaibatsus*, which dominated the Japanese economy before World War II. After the war, the occupational forces attempted to break up the monopoly of the *zaibatsus*, which had helped the Japanese government in the war. But soon, they realized that a strong Japan was needed to fight the Korean War and the expansion of communism. Substantial aid was poured into the Japanese economy, and the attempts to break down the Japanese corporate structure were abandoned. *Zaibatsu* companies that were broken down were free to regroup. Some regrouped around banks and trading companies that held shares in other firms too. The resultant conglomerates are the *keiretsus*. A *keiretsu* is a tight network of companies that share capital, R&D, customers, vendors, and distributions. *Keiretsus* also maintain ties with the government. Major *keiretsus* have the ability to control nearly every aspect of the value chain in a variety of industrial, service, and resource sectors.

There are two types of *keiretsus*: horizontal and vertical. A horizontal *keiretsu* is a cluster of companies around a bank from related or unrelated industries. Large horizontal *keiretsus* are found in many industries, including banking, insurance, steel, trading, manufacturing, electric, gas, and chemicals. Members use each other's products and services and are given preferential treatment. In effect, they form a production system that is distributed among many firms. Many assert that such preferential treatment and the purchasing habits of *keiretsus* are barriers to free trade and major impediments to foreign investment, products, and services. The major banks, Mitsui, Mitsubishi, Sumitomo, Fuyo, Sanwa, and Dai-Ichi Kangyo, belong to horizontal *keiretsus*.

A vertical *keiretsu* is a network of companies around a major manufacturer. The manufacturer itself may be a member of a horizontal *keiretsu*. While the members of a horizontal *keiretsu* are from diverse industries, members of a vertical *keiretsu* are from a single industry. The members consist of suppliers and distributions that serve a large manufacturer at the core. Vertical *keiretsus* include large manufacturers such as Toyota, Nissan, Honda, Matsushita, Hitachi, Toshiba, and Sony.

It appears that globalization and the changes that are taking place in the Japanese economy along with the demands by foreign governments are causing *keiretsus* to drift away from a “network” model and open up to—even form alliances with—foreign business.

Degree of Internationalization The degree of internationalization affects organizational structure through headquarters-subsidary relationships. The foreign subsidiary's autonomy and internationalization of the firm are related. Internationalization can be defined as the number of foreign countries in which a firm has subsidiaries. As the number of foreign subsidiaries increases, so does the complexity of managing them. It is expected that MNCs with a high degree of internationalization may be forced to allow more autonomy to their subsidiaries for certain decisions such as marketing. For other decisions such as finance, however, they may exert more control because the intimate knowledge of local situations is more critical in marketing than in finance.

The Development of an International Corporate Structure

As a mechanism that facilitates progress toward goals, organizational structure evolves to accommodate the implementation of strategies. Firms follow different paths to international expansion, which assumes many different forms. The organizational structure of most international operations evolves to serve the growing needs of their diverse markets. Consequently, their choice of the structure depends on the type of strategy employed. An organization's structure not only signifies distribution of power and authority and a formal relationship between organizational members, but it also indicates the importance the company places on certain aspects of the business. A company organized along customer groups, for example, signals emphasis on meeting the needs of its customers.

As the firm grows, so does the significance of its structure. A small business requires a simple formal organization. But as it expands, increased specialization of tasks and duties creates an additional demand for coordination and integration. A more sophisticated structure is needed to handle the complexity of the operation and the coordination and integration requirements of a large firm. Such a structure would also facilitate the efficient distribution of the firm's resources and the execution of its strategies. The structure that served the business of a domestic firm may be ill-equipped to handle the diversity of the international marketplace. International expansion brings about structural changes. A three-phase evolutionary process characterizes the changes in the organizational structure of MNCs. The progression through these phases parallels the three stages of introduction, growth, and maturity of a product's life cycle (Sect. 13.4) [15]. The firm thus transforms from a domestically oriented one and passes through three phases—namely, international, multinational, and global.

International Orientation In the first phase, competition is limited to a small number of companies located in developed countries. These firms manufacture products with functions, features, and characteristics that are designed for the domestic market. International operation for these firms consists only of exports. Although exports may be an important source of revenue, they constitute only a small portion

of the total corporate earnings, so international operations are merely an appendage to their domestic business. At this stage, firms continue using the existing domestic structures, with some minor additions to accommodate business activities across national borders.

Multinational Orientation In the growth stage, technology diffusion and price competition, particularly from domestic firms, force firms to establish manufacturing facilities in low-cost locations abroad. As increased foreign sales make up a larger share of corporate revenues, firms enter the second phase by changing the organizational structure to include the international division structure. All international business activities are organized into a division comparable with other divisions on the domestic side of the business. There is no attempt to integrate foreign subsidiaries, and operations within each foreign country remain separate from one another. Some firms go through a transition phase before entering Phase 3, in which they attempt to learn the intricacies of the international environment through their autonomous foreign subsidiaries. A major portion of the MNC earnings come from these autonomous foreign subsidiaries, which are given substantial decision-making freedom.

Global Orientation In Phase 3, most of the corporate revenues are generated from abroad. At this stage, MNCs organize their operations on a global basis. Domestic operation becomes one aspect of their business and receives corresponding attention along with foreign operations. Various forms of organizational structure that involve the transition from a domestic form to an international structure are discussed next.

A Global Company

Asea Brown Boveri (ABB) is a global electronic equipment company created by merging Asea, a Swedish engineering group, with Brown Boveri, a Swiss competitor, and adding on more than 70 other companies in Europe and the United States, with joint ventures in South Korea and Taiwan. ABB became very efficient by getting rid of excess capacity and eliminating duplication and reducing waste. There are no more than a dozen executives at the headquarters in Zurich, making up the executive committee that consists of American, German, Swedish, and Swiss managers. Since there is no common first language, they speak only English. The executive committee is responsible for ABB's global strategy and performance, and more than 50 business area managers report to them.

To leverage its core technologies and global economies of scale without sacrificing local responsiveness, ABB used a loose, decentralized version of the matrix organizational structure. ABB organized its operations along a matrix system of 50 or so business areas (BAs), which were grouped into 8

(continued)

business segments, each of which was the responsibility of a member of the executive committee. An example of a business segment is a group of five BAs that sells components, systems, and software to firms for automating their industrial processes. This business segment includes metallurgy, drives, and process engineering. Its office is located in Stamford, Connecticut.

BA managers devise strategies to optimize the BAs globally. They are responsible for the cost and quality standards, allocation of export markets to factories located around the world, and sharing of expertise by rotating people across borders. National managers, who are responsible for local firms within national borders, report to BA managers. Most of the national managers are host country citizens. The local companies act as national firms and have their own boards, which may include eminent outsiders, presidents, financial reporting, and career ladders for employee advancement. The managers of local firms have a global boss, the BA manager, who sets the overall framework for the operation of the BA. They also report to the country manager, who coordinates the activities of national firms [16–18].

The International Division Structure

At the early stage of international expansion, firms' interest and expertise are centered on domestic operations, and its international involvement is incidental. Often, international sales are triggered by foreigners' inquiries and are insignificant compared with domestic sales. The lack of competition and the firm's superior technology lead it to export the existing products or product line without many modifications. As international sales increases, the firms may set up an in-house export desk or export unit. An export manager, who reports to the marketing executive, is given the responsibility of handling all export activities. The export manager's position and reporting arrangement depend on the breadth of the product line. In a firm with a narrow product line, the export manager reports to the chief marketing officer. In a firm with a broad product line, the export manager reports directly to the chief executive officer [19, p. 82]. As the volume of sales and revenues increases constantly, the firm may establish an office abroad to handle product sales and service. Now, the firm is compelled to impose more coordination and control and needs an organizational structure that can deal with the diversity of expanded foreign business. At this stage, MNCs adopt an international perspective and use international division structures (Fig. 8.2). This organizational structure is typically associated with an international strategy introduced in Chap. 6.

Three factors prompt the establishment of an international division structure that enjoys sufficient organizational status on par with the other divisions [20].

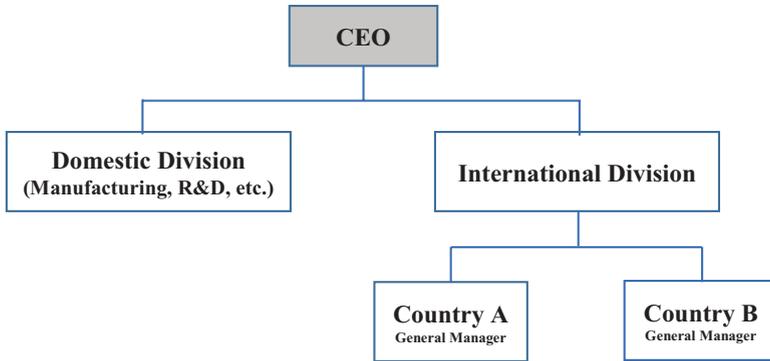


Fig. 8.2 International division structure

1. **Increased international involvement:** Operational and strategic attention and involvement of a senior executive and the structure of a separate organizational unit are required.
2. **The early stage of internationalization:** The geographic diversification of business operations is not significant. The concentration of all international activities in a single organizational unit is the best way to deal with the complexity of the global market and exploit worldwide business opportunities.
3. **The requirement of international market specialists:** There is a realization that internal specialists are needed to deal with the special features of global markets and assess global opportunities and threats rather than passively responding to conditions that are presented to the firm.

In an international division structure, the management of foreign operations is coordinated by an international division of the firm in the home country. Each subsidiary (or sales offices) manager reports directly to the head of the international division. The executive in charge of the division is a member of the corporation's executive board. All activities of foreign operations are centralized at the international division, and the head of the international division is given line authority over the foreign subsidiaries. Through the international division, the MNC headquarters exercises control and coordination over foreign operations without much change in the corporation's existing structure. With the creation of an international division, the loss of autonomy of the foreign subsidiaries is matched by a corresponding measure of guidance and support from the corporate staff (see Refs. [15, Sect. 13.5; 19, p. 155]). In effect, the international division allows the firm to maintain separate domestic and foreign businesses and to use its limited international expertise efficiently. Since the firm basically has a domestic orientation, not many executives have international experience. The concentration of international staff in the international division allows for integration, coordination, and control of foreign subsidiaries without placing undue demands on the other executives.

The international division corporate structure is likely to be adopted by firms with a dominant domestic business, a narrow product line, limited geographic diversity, and few managers with international business expertise and experience. With the dominance of domestic business over international operations, upward mobility of the executives in the corporate hierarchy is not tied to international expertise and experience. Therefore, not too many executives see the knowledge, experience, and expertise associated with international business as necessary for their career progress. Often, a foreign assignment may be an organizational hindrance that could limit their managerial advancement. By spending a few years abroad on foreign assignments, they could become outsiders to the domestic corporate network. They could be bypassed for promotion in favor of those who are active in domestic operations and who are a part of the internal power network.

An international division structure is a manifestation of the firm's international orientation and geographic interests, which are translated into design arrangements fitting the multinational nature of its foreign operations. The firm, at this stage, considers each geographic area to be a separate market that requires differentiated business practices that are handled by foreign subsidiaries. These subsidiaries, although separated operationally, could benefit from the overall guidance and integration efforts of headquarters. There is a need to balance the self-interest of foreign subsidiaries with overall corporate performance, by standardization of the information control mechanisms of foreign subsidiaries. The structure of the international division and the associated standardization allow for the application of international corporate practices that improve corporate performance, such as transfer pricing, resource acquisition and allocation, and product distribution (Sect. 13.5) [15].

Polaroid is an example of a firm that has used the international division structure. During the 1980s, nearly 40% of Polaroid's revenues came from international operations. Its international division controls all manufacturing and marketing functions outside the United States. It has three facilities, in Scotland, Ireland, and the Netherlands, that handle many aspects of manufacturing Polaroid products. It essentially sells abroad the same products as those sold in the domestic market, with some modifications to accommodate special market conditions, local regulations, and metric measures. The international division markets the full line of Polaroid products through wholly owned subsidiaries in 20 countries. It is treated as a profit center and seems to enjoy a degree of independence within the corporation that is envied by other divisions [21, p. 513]. The recent reorganization has carved the firm into three major business units—consumer, industrial, and magnetic. It seems that Polaroid is experimenting with the goal of creating a matrix organization design [22, p. 102].

Coleman Corporation, based in Wichita, Kansas, is another firm that has employed the international division structure for many years. Coleman is the largest manufacturer of outdoor products in the world. Its product line, especially gasoline-powered lanterns and insulated coolers, has gained worldwide recognition. Coleman started its international operations in 1919 and has had an international division structure since the 1940s. The division is headed by an executive-level vice president and is located a few miles from the corporate headquarters.

The international division structure works well for Coleman, which has a rather centralized manufacturing operation and a narrow, homogeneous line of products. Coleman has its principal manufacturing sites in Wichita and Inheiden, Germany. There are other, smaller manufacturing sites in Texas, South Carolina, Utah, and Washington. Outdoor products are manufactured at the Wichita, Inheiden, and Texas sites. The Utah and South Carolina facilities make textile products, such as sleeping bags and tents. Portable generators are produced in Nebraska and water skiing equipment in Washington.

Coleman outdoor products generally need little modification for sales in foreign markets. The changes that are made are generally cosmetic, such as labeling and packaging changes. In the United States and developed countries, Coleman products are used for recreational purposes. In these countries, advertising and marketing are relatively undifferentiated. Adjustments are made for variations in the infrastructure of the markets and for differences in cultures and languages. An example is Japan, where there are many small retailers and long channels of distribution. Products are used recreationally, however, so advertising and marketing tactics are similar to those in Europe and the United States.

In developing countries, Coleman products often serve basic utility functions. Lanterns are a primary source of light, and insulated coolers are a principal source of refrigeration. Therefore, in these countries, the marketing mix is differentiated, and the distribution is through dealers with an emphasis on product promotion. Coleman does not coordinate advertising but, instead, provides free products for demonstration based on the distributor's promotion efforts.

Except for Inheiden, the international division is centralized at the headquarters. At Inheiden, Germany, Coleman manufactures products for sale to European markets. Inheiden also coordinates European sales operations and regional sales and distribution offices in Bristol, England, and Alphen aan den Rijn, the Netherlands. The international division coordinates all other regional sales and distribution offices, including Tokyo, Singapore (which covers the rest of Asia), Sydney, New Zealand, and San Juan, Puerto Rico (which includes Latin America and the Caribbean).

The international division structure at Coleman reflects the characteristics of various foreign markets and Coleman's strategic approach in serving those markets. Europe has long held business opportunities in outdoor products. The interest in outdoor recreation and the higher level of income make Europe a large market for Coleman products. Consequently, European operations are significantly larger than operations in other countries and are afforded more local decision-making power. In a sense, market characteristics determine either centralization or autonomy of the operating units.

While Europe has been Coleman's largest foreign market, Japan is its fastest-growing market. During the 1980s, Coleman became the largest vendor of outdoor products in Japan. The increasing popularity of outdoor activities among the Japanese combined with the fast rate of market growth may make the Japanese market equal to that of the United States for Coleman's products. It is also expected that the market for outdoor equipment will increase in the rest of the Asian and the

Latin American countries. These changes in the external environment will have a structural impact on Coleman, as foreign sales surpass domestic sales. Until then, an international division structure seems to be appropriate for Coleman, based on its narrow product line and a dominant domestic business.

MNCs typically continue to use the international division structure as long as it remains smaller than most domestic divisions. It is abandoned in favor of other structures when it rivals the largest domestic divisions. However, the international division structure may last longer if the rest of the MNC is organized along the geographic structure, because there is a better fit between a geographic structure and an international division. The increased volume of business results in increased size, which in turn strains the capacity of the division to handle the MNC's product diversity and geographic dispersion. At this point, the worldwide activities need corporate direction. A very strong international division, however, hampers headquarters' direction of worldwide operations. The increased size of the international division, which is accompanied by more independence, "tends to insulate the headquarters from international operations and the corporate management from overseas problems and opportunities" [20, p. 257].

The international division needs the product expertise possessed by domestic divisions. Domestic division staff, however, are reluctant to share their expertise with foreign operations due to differences in their goals. Consequently, the need to reorganize leads to one of the two forms—an international product division or an international geographic division.

Advantages

The choice of any organizational design represents the trade-offs between the benefits gained and the limitations imposed on the management of the firm. The international division structure provides a few benefits, including the adequate top management attention to foreign business, the concentration of international management expertise at the headquarters, and the acquisition of capital and resources worldwide (see Refs. [6, pp. 259–260; 19, pp. 85–86]). Since the head of the international division is a member of the senior executive team, the firm is constantly reminded of the international implications of strategic decisions. The existence of international expertise at the headquarters expedites coordination between functional units, such as marketing, finance, production, and foreign operations. The presence of international managers at the top corporate hierarchy and their participation in strategy-making committees facilitate evaluation of investment decisions on a worldwide basis.

Disadvantages

The international division structure has some drawbacks (see Refs. [6, pp. 259–260; 19, pp. 85–86; 23, pp. 256–257]). There is an inherent conflict between the goals of the domestic and international divisions. Almost always, products that are sold abroad are those produced for the domestic market. The international division does not have its own R&D and engineering staff. Therefore, it cannot cater to the special needs of its foreign customers. Domestic functional specialists are reluctant to give

priority to foreign customers because the evaluation of their performance is based on domestic criteria. The international division, therefore, relies heavily on the cooperation of domestic functional departments, and such cooperation may not be forthcoming. There is also another source of conflict. Some activities, such as financing and resource acquisition, need to be coordinated internationally at the divisional level. Attempts at the divisional level to exercise central control over financing clash with country-level activities, such as local marketing. Domestically, the firm gives high priority to product coordination as compared with area coordination (a divisional activity). The international division, however, needs both product and area (geography) coordination.

The Geographic Division Structure

The geographic or regional structure divides worldwide operations into regional divisions. The responsibility for managing each geographic area goes to a senior-level executive (see Fig. 8.3). These executives have operational and human resource management responsibilities for their regions, while the headquarters maintains strategic planning and control for worldwide corporate operations. The headquarters grant autonomy to foreign subsidiaries and allow them to operate freely as independent business units. Autonomous foreign subsidiaries can integrate into the economic context of the host country and develop their own competitive posture. They gain a competitive advantage by setting up local manufacturing, marketing, and purchasing. By operating as a local firm, they can tap the domestic source of cheap labor and are faced with fewer restrictions. In addition, their independence from headquarters enables them to consider local consumers' needs in making major decisions and to be sensitive to local markets and governments. The direct relationship between the foreign subsidiary and headquarters makes it possible to present the subsidiary's problems at the highest corporate level without additional levels of bureaucracy. It also elevates the prestige of the subsidiary's managers in the eyes of host government officials and immensely improves their negotiation status [6, p. 257].

However, when a subsidiary's contributions to corporate earnings become large enough to warrant closer scrutiny and when the rate of international experience accumulated by the headquarters increases, the headquarters begins a search for ways to exercise more control. Also, as the corporate executives become more familiar with foreign operations, they begin to feel more confident in establishing more coordination and control among foreign operations through organizational design modifications.

Given the nature of subsidiary independency, firms adopting a host country focus strategy (introduced in Chap. 6) tend to have a geographic division organizational structure. McDonald's is an example of a firm adopting the geographic division structure. McDonald's has over 36,525 restaurants in 119 countries (as of 2015) and is managed as distinct 5 geographic segments, comprised of the United States, Europe, Asia-Pacific, Middle East, and Africa [45]. And under the geographic

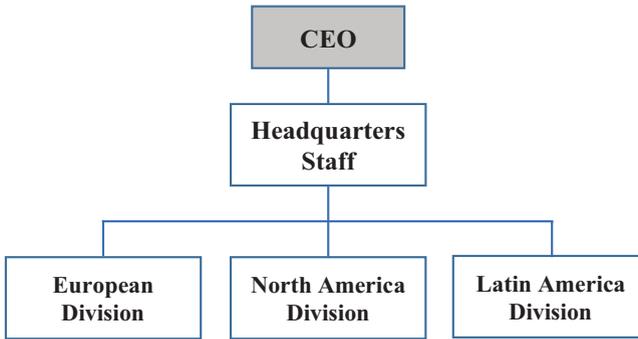


Fig. 8.3 Geographic division structure

division structure, subsidiaries of each region focus on their own regional market and customize a market-mix strategy (e.g., product, price, place, and promotion) to meet the cultural needs and customer tastes/preferences of that market.

Advantages

The geographic division structure is suitable for certain products and market characteristics. The advantages of the geographic division form are the possibility of regional economies of scale and the treatment of country subsidiaries as profit centers. The geographic division works well when regional similarities in customers' preferences allow for standardization and create the opportunity for economies of scale. It is also suited to situations where whole regions can be treated as a market, with modest marketing modifications for individual countries. Firms using regional structures tend to have mature businesses and narrow product lines and a greater growth prospect abroad, where their products are still new. Since these firms generate large earnings from foreign markets, they need an intimate knowledge of the local environment. They generally emphasize low-cost manufacturing by establishing large plants and using stable technologies. They try to create competitive advantages through marketing techniques and price and product differentiation. Automotive, beverages, containers, cosmetics, food, farm equipment, and pharmaceutical industries have characteristics favoring the regional structure (Sect. 13.7) [20].

Disadvantages

Although a regional structure simplifies the task of top management by creating regional specialists, it may cause problems (see Refs. [6, p. 264; 15, Sect. 13.9]). A firm with a diverse product range may find that the regional structure is inadequate to handle coordination among product lines and between the country subsidiaries. The regional structure tends to emphasize coordination and integration within an area at the expense of overall corporate integration. It may focus too much attention on regional performance, which may not necessarily optimize overall corporate interests. Rivalry among the regions may sacrifice the cooperation needed for global competition and may create too much duplication of functional and product

specialists among the regions. Strong regional managers may block or delay the implementation of strategies aimed at taking advantage of global economies of scale and worldwide opportunities. MNCs using a geographic division structure may experience difficulties with the transfer of new production techniques and new product ideas from one country to another and the optimum flow of products and material from diverse sources to world markets. Firms facing this problem may respond by establishing a worldwide product manager at the corporate headquarters. This manager is assigned responsibility for particular products or product lines worldwide. Product managers promote the development, progress, and dissemination of product ideas and production worldwide. They recommend global product strategies and act as a clearinghouse for the transfer of successful developments from one area to the rest of the MNC. This represents experimentation with the matrix structure, which is discussed later. It is likely, however, that they will encounter an ambiguous operating relationship with geographic division managers, who have line responsibilities [20, p. 261].

The Product Division Structure

Firms using a product division structure arrange their business into product groups and assign a senior line executive total responsibility for each product division (Fig. 8.4). As in the regional structure, strategic decisions within each product division that affect the total MNC operations are made by headquarters. Products using similar technologies and having similar customers are grouped within a division. The total responsibility of serving the world market rests with each product division, which plans service strategies within the guidelines established by headquarters. These plans need headquarters' approval before they are implemented. Corporate staff provides financial, legal, technical, and other functional services and guidance to all product divisions. Thus, it is more a centralized organizational structure in which firms organize international operations based on their major products and plans made by the headquarters.

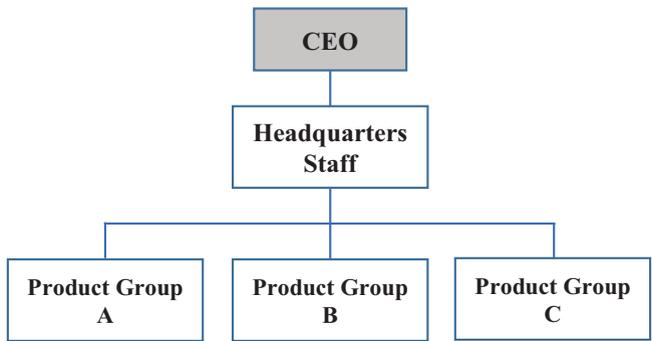


Fig. 8.4 Product division structure

Firms adopting the global integration strategy and with diverse product lines and a high degree of coordination within each product line for sharing of technology and manufacturing the product tend to use the product division structure. Their products typically have a relatively high level of technological content and different end users. Because of a varying requirement of marketing for these products, there is a need for product and market integration among them. The product division structure makes it easier to market such products and provides product and market integration.

Hewlett Packard is a firm that has been using the product division structure to serve the world market. In 1970, Hewlett Packard established its first product groups, with four divisions. In 1975, the product groups expanded to six: electronic test and measurement instruments, computer and computer-based systems, calculators, solid-state components, medical electronic products, and electronic instrumentation for chemical analysis. Each division was responsible for all aspects of business within its product group, including manufacturing, sales, and services. Product groups also prepared sales forecasts and recommended prices. The general managers of product divisions reported to two executive vice presidents who were jointly responsible for operations. Product divisions were supported by the corporate staff reporting to the vice president for administration [24].

Advantages

The benefits of product division are realized when high transportation costs, tariffs, and other considerations favor local manufacturing of the product. By emphasizing the product market and taking advantage of advanced technology and product expertise, multinational operations are better served by this type of structure. The flexibility of division by product allows the MNCs with growth strategies to add new product divisions without disturbing the rest of the organization [8, pp. 97–99]. It also facilitates fast response to the global competitive pressures against specific product lines. The global competitive maneuvers of international rivals are spotted faster by product division executives. Therefore, the MNC can effectively concentrate and apply its resources at the location of the competitive attack.

Disadvantages

A product division structure may result in wasteful duplication of management, sales representation, and plant capacity utilization within regions [25, p. 262]. A customer, for example, may be visited by representatives from different product divisions. To eliminate duplication and waste, coordination among divisions would be necessary. Within a given geographic area, however, the coordination of different product division activities may be difficult. The addition of country managers, who do not have profit responsibility, may overcome this shortcoming. Country managers report to appropriate product divisions for their share of local activity and perhaps to a regional staff specialist for their role in maintaining a local presence (see Refs. [6, p. 266; 15, Sect. 13.11]). In this manner, the country managers function as if they are operating in a matrix organization.

The Functional Structure

In a functional structure, the responsibilities of managing the MNC’s operations are organized by functions. Each business function, such as manufacturing, marketing, finance, R&D, and human resource management, is assigned to a top-level executive. Each executive has a worldwide responsibility in his or her functional area and reports to the chief executive officer of the MNC (Fig. 8.5). The manufacturing executive, for example, has line authority over, and is responsible for, all manufacturing activities, domestic and foreign, within the MNC organization. This form of structure works well in a situation where the firm has a narrow, standardized product line [8, p. 94], and its global coverage and demand have reached a plateau, with no serious changes in the competitive challenge [6, pp. 259–260]. A functional organization allows tight centralized control with a small cadre of functional managers.

Except in raw material extractive industries, the functional form is less popular among MNCs. In a survey of 92 American MNCs, only 10 had a functional structure, and all were in the raw material extractive industry [26].

Advantages

A functional structure seems to work well in the raw material extractive industry because raw materials are very homogeneous and processes do not differ substantially from one country to another. Coordination among the functions, such as exploration, production, and sales, is of strategic importance, not the introduction of new products or marketing. All major oil companies, for example, have exploration, crude oil production, transportation (tankers and pipelines), refining, and marketing worldwide. Functional design permits line managers to control directly all activities, at each step, globally through the process of product flow.

Disadvantages

For a firm with a multiple product lines, the use of a functional structure could create problems. It puts undue demands on functional managers, which are not easily met. These managers would need expertise in multiple product lines and regions. Another problem is the inherent divergence of objectives among functional managers. The conflicts resulting from differences in objectives between functional managers, such as marketing and production, which cannot be resolved at the country

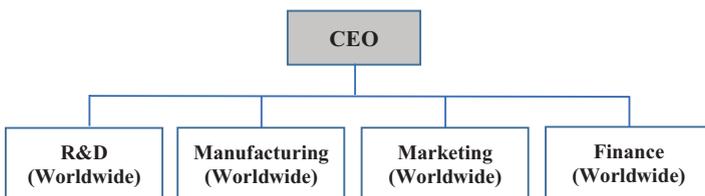


Fig. 8.5 Functional structure

level, need to be referred to headquarters. A headquarters overburdened with reconciling and resolving conflicts among the functional divisions has less time for strategic decisions.

Global Matrix Structure

Ever since its introduction, the matrix structure has been praised and criticized by both business scholars and managers. Matrix management is an organizational form in which normal hierarchy is overlaid by some form of lateral authority, communication, and influence. A matrix organization does not follow the traditional principle of unity of command, which prescribes that each subordinate will have only one superior. It usually combines two chains of command—one along functional/product lines and the other along geographic areas (Fig. 8.6). There are dual channels of authority, performance responsibility, evaluation, and control in a matrix organization.

Dow Chemical pioneered the matrix management structure since the 1960s and still uses a more flexible version of it. Dow's operations are arranged in the form of three overlapping components: functional, business, and geographic. The functional components include manufacturing, R&D, marketing, and so on. The business segment consists of product lines. The geographic part encompasses the countries where Dow has business operations [30]. As can be seen from Fig. 8.6, subsidiaries in different regions involve in the development of the same product; optimize operational efficiency by sharing resources, technologies, and manufacturing activities across subsidiaries through a flexible coordination mechanism; and adjust their operations to be able to respond to local demands/needs. As such, the global matrix structure is widely used by MNCs focusing on the transnational strategy (Fig. 8.7).

Given the nature of the global matrix structure, it could be viewed as the end product in a sequence of lateral coordinating arrangements that encompass liaison

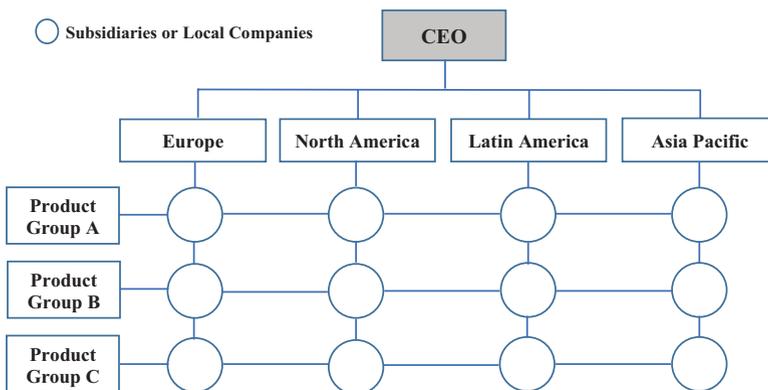


Fig. 8.6 Global matrix structure

roles, task forces, teams, integrating managers, integrating departments, and finally matrix [31]. The matrix structure is a delicate system to manage. Experience indicates that firms that succeeded in building multidimensional organizations, such as the matrix, are those that begin by building an organization instead of installing a new structure. In other words, these firms first altered organizational psychology and built a strong organizational culture. Then, they reinforced organizational psychology with improvements in organizational physiology by building the proper structure [32].

Citicorp, Digital Equipment, General Electric, Shell Oil, and Texas Instruments are among the well-known firms that have used matrix design [28, p. 333]. However, some large companies such as Xerox and Philips have recently abandoned the matrix structure, claiming it had created a stranglehold on product development and slowed decision-making [29, 30]. Peters and Waterman [31] even asserted that the tendency toward hopelessly complicated and ultimately unworkable structures “reaches its ultimate expression in the formal matrix organization structure” (p. 49). Now, we describe below the pros and cons of global matrix organizational structure.

Advantages

A matrix structure offers many advantages. It enables the efficient use of organizational resources. Specialists, as well as equipment, can be shared across multiple projects or countries. It also provides a clear and workable mechanism for coordination work across functional lines, facilitating project integration. Vertical information flow should improve in a matrix form since one role of the country manager or the project manager is to be a central communication link with top management. In addition, lateral communication is normally very strong due to the necessity of such communication. The result is improved interaction both vertically and laterally. Frequent contacts between members from different areas expedite decision-making and enhance management flexibility.

Disadvantages

The matrix structure has several disadvantages. Proponents praise its efficiency and flexibility, while critics say the matrix is costly, cumbersome, and overburdening to manage. It has a built-in tension between country managers and product managers, who are in competition for control over the same set of resources. Such conflict is viewed as a necessary mechanism for achieving an appropriate balance between product issues and unique country requirements. The effect on morale, however, can be very damaging. Oftentimes, work conflicts resulting from differences in objectives and accountabilities disputes about credits or blames, and infringements on professional domains spill over to a more personal level. Any situation in which equipment and personnel are shared across projects lends itself to conflict and competition for scarce resources. The time-consuming nature of shared decision-making, while enhancing flexibility, also increases costs. The additional managers increase administrative overhead. The very nature of matrix structures creates

situations in which “when everyone is responsible, no one is responsible.” In effect, “passing the buck” is easy in a matrix organization.

Firms using the matrix structure are aware of the problems, and some have moved to minimize their impact on the organization. Dow Chemical, for example, found that instead of promoting communication, a matrix design created a labyrinth of bureaucracy (e.g., complex communication between headquarters and business units), many committees, and miles of red tape. Given this disadvantage, the company revamped its organizational structure. To be more flexible and responsive to local markets and to reduce communication costs between headquarters and geographic business units, the firm gave the ultimate authority to geographic managers.

“Moving forward, we will have less structure at the top of the company with more deployment and implementation in the markets and out in the field” said Chairman and Chief Executive Andrew N. Liveris. “We will have less centralization and more decentralization.” [27]

Mixed Structure

Some firms may find geographic and product division structures inadequate for their expanding operations. These forms are too restrictive for the ever-changing pattern of international business activities. Therefore, these organizations have opted for either a mixed design or a matrix form. The mixed or overlapping design is a combination of the other structures. One option is to combine functional and product divisions. Another choice is to mix geographic and product lines. A third version combines functional and geographic divisions. Or firms can simply adopt multiple organizational structures depending upon their product divisions. For instance, DuPont company uses a functional structure for oil division, a product division structure for pharmaceuticals division, and a matrix structure for plastic division.

A major reason for the adoption of a mixed structure is that other designs do not allow for optimum integration of inputs from regional, functional, and product areas. An optimum level of interaction and cross-fertilization among the three areas is necessary to gain a competitive position in the ever-changing global market. MNCs are constantly in search of a structure that combines area knowledge with product and functional skills [8, p. 95].

Newer Forms of Organization

MNCs and domestic firms alike are in constant search for the best possible organization design. Although functions, products, and geographic areas remain the three basic models of organizational structure, each has shortcomings that limit its application. The efforts to combine the benefits of all three models while keeping the drawbacks at a minimum produced the matrix structure. Although the matrix design offers the flexibility and quick response needed in a dynamic global business

environment, it is not the final answer to the organizing needs of the MNCs. Many firms that were enthusiastically promoting the matrix earlier are now not quite sure of its benefits. Some have found it too cumbersome and confusing and have abandoned it in favor of market-based designs.

Market-Based Design

A market-based design takes into account market differences in structuring the firm. A market could be a group of countries that have a similar pattern of needs, purchasing behaviors, and product use. Based on these criteria, the world could be divided into a few markets that could be served with similar products and services. The advent of the Internet and modern communication technologies has reduced the problems associated with geographic separation between different units within each market. Therefore, the physical proximity that is the basis for the geographic division structure is abandoned in favor of more meaningful market characteristics. Instead of dividing the world into geographic regions, such as South America, Europe, and East Asia, for example, countries could be categorized by their level of economic development. On that basis, for example, Brazil, Mexico, South Korea, Taiwan, Turkey, and the OPEC countries could form one market (Sect. 13.14) [15].

Strategic Business Units

Based on the logic of market-based design, General Electric established its planning around “strategic business units” (SBUs)—families of businesses that encompass product and geographic dimensions. The older structure serves as a supportive skeleton on which the newer structure of an SBU is overlaid. Xerox Corporation has done similarly by discarding its matrix structure in favor of SBUs [29, p. 58]. While the limitations of travel and communication over long distances coupled with the advantages of physical proximity for managing were the basis for adopting the geographic division structure, advances in telecommunications and information processing have reduced both the limitations and the benefits. Such developments have, in turn, enabled firms to use market-based and SBU structures.

Networks

There are two paths to internationalization: the traditional path and the new path. The new path is provided by the free trade system and the network of its participants, which act as a springboard from which firms can launch themselves directly to the global stage. In doing so, they become a part of the network and acquire network structures.

Previously, not having a large home market was a hindrance to growth and internationalization. While many European firms by necessity were engaged in cross-border businesses, their operations were merely an expansion to neighboring markets that were within a few hours of travel time. Today, globalization has made it possible for the firms from small home markets to expand globally. Because of their small home markets, these firms are forced to use innovative strategies that consider the whole world as a market. Also, they are free to design organizational structures that are not burdened with intermittent, large-scale modifications, such as

those that traditional companies had to go through—namely, progression through domestic, international, multinational, and global structures. From the beginning or at an early stage of their growth, they become global players.

Characteristically, globalization makes it possible for small- and mid-sized firms, as well as start-ups, to become global operators. A global market is a vast network of many firms, in many industries, with a multitude of links to each other in the form of supplier-buyer-customer, marketer-middle man-service provider, and so on. According to the United Nations, for example, there are 60,000 firms with more than 800,000 national affiliates operating in the global market [30]. This vast network is at the disposal of those who have the ingenuity of knowing how to use it.

Unencumbered by the organizational memory of old methods and free from organizational habits, traditions, culture, and structure that are past-oriented, newcomers to the global market can move quickly and effectively. Often, it will take these firms much less time to become global players than their traditional counterparts took to reach a global status. Particularly, the development of the organizational structure of these firms follows a less cumbersome path, which takes them directly to global design. Traditionally, the organizational structure of the firm goes through successive states—namely, domestic, international, multinational, and global. But innovative newcomers, all of which start with a much smaller size than existing global companies, acquire a global posture and structure in a short time. Because they move quickly to the global level, these firms do not use any of the conventional designs. They use an innovative, fluid, and organic structure. This structure is in congruence with the network character of the global economy.

The global economy is emerging as a worldwide web of interfirm connections [2, p. 41]. Internationalization, therefore, can be defined as the process by which firms are becoming integrated into the worldwide web of economic activities. From this perspective, the major features of the global economy—namely, the size and the weblike character, the free trade system, and the existence of global customers—push and pull firms to become global players using innovative organizational designs.

The push comes from the size of the network of the global market, which cannot be managed by conventional methods if a firm does not have a considerable resource base. Also, from their inception, most of these firms have a global mission.

The pull comes from the free trade system, which allows cross-border transactions without many restrictions and makes faraway people the next-door customers. Even niche players, which previously did not have enough customers at home to grow, can find enough customers in distant places. The pull also results from the fact that existing global companies need suppliers to service their operations in multiple markets. These global customers pull competent and imaginative newcomers to the global stage. If the newcomers are to serve these customers and move quickly, they cannot be burdened with the rigidity of traditional forms. They devise their own forms, which do not fit into conventional designs. These firms are characterized by their connections with suppliers, marketers, and other firms and, where needed, with the local governments. We call these forms a “network” design. The network, however, is neither a solid form nor a design that has a permanent skeleton on which the organizational requirements of job design, authority-responsibility designation,

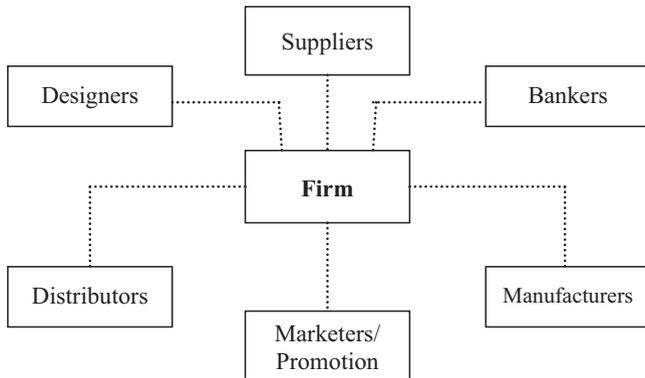


Fig. 8.7 A simple view of network organization

communication, and relationships could be fleshed out. It is more of a multidirectional organization rather than either a vertical or a horizontal organization. It is in a permanent state of evolution and mostly involves external relationships with other firms and their own subsidiaries and joint ventures. The framework of a traditional organizational structure cannot portray a network organization because this form of organization relies on dynamic relationships. It is not a hierarchical and authority-based firm but a “hyperarchy.”

The network structure is very young. It is closely tied to another form of organization called a *virtual corporation*. In 1992, Davidow and Malone [36], after a careful observation of the world’s most advanced companies, suggested that the successful future firms of the twenty-first century will be the “virtual corporations.” When asked what a virtual corporation would look like, they replied:

There is no single answer. To the outside observer, it will appear almost edgeless, with permeable and continuously changing interfaces between the company, supplier, and customer. From inside the firm, the view will be no less amorphous with traditional offices, departments, and operating divisions . . . [but] even the very definition of employee will change, as some customers and suppliers begin to spend more time in the company than will some of the firm’s own workers. (p. 7)

Instead of asking “How does it look?”, maybe we should ask “How does it work?” To describe the nature of the products and production processes of the virtual corporation, Davidow and Malone borrowed the words of the manufacturing expert Earl Hall:

The complex product markets of the twenty-first century will demand the ability to quickly and globally deliver a high variety of customized products. These products will be differentiated not only by form and function, but also by the services provided with the product, including the ability for the customer to be involved in the design of the product. . . . A manufacturing company will not be an isolated facility of production, but rather a node in the complex *network* [italics added] of suppliers, customers, engineering, and other “service” functions.

The virtual corporation is very tightly coupled with customers and suppliers. Customers participate in product design, and suppliers have access to most of the company's resources that previously were the exclusive domain of the firm. Suppliers, the firm, and customers are partners. In short, a virtual corporation appears "less a discrete enterprise and more an ever-varying cluster of common activities in the midst of a vast fabric of relationships" (p. 7) [36].

The network structure has been used by the apparel industry for a long time. Many clothing designers do not make their own clothes. Others do it for them much cheaper and better. At the heart of a virtual corporation is the readiness to rely on other companies, technologies, and engineers, all of which may be scattered around the globe [40]. Flexibility, speed of response, low costs, and local connections are the obvious benefits of a virtual corporation, but there are some risks involved. First, there is a loss of control over the functions of the partners, who may not fulfill their part and may not be vigilant in safeguarding proprietary information. Second, the structure poses new and demanding challenges to managers [37]. They need to work in a less hierarchical organization, become accustomed to having less control, and accept that the top-down strategy approach is inappropriate in the global economy, where "on-spot information" disperses knowledge throughout the firm, to its suppliers, customers, and other relevant businesses. This is a new reality acknowledged by the organizational theorist, who envisions even radical forms of "disposable organizations."

As rates of change have accelerated, processes of knowledge acquisition that emphasize direct experience within a particular organization have probably become less important to competitive advantage than those processes that emphasize more analytical and broader knowledge. Research and education have become more important; individual and organizational experience has become less relevant. As a result, the comparative advantage of the individual organization as a sustained accumulator of idiosyncratic experiential knowledge has declined. [38, p. 430]

Let us take a look at the mechanisms of two networks in practice: one is the case of Taiwanese ventures into Mainland China and the other is practiced by an American corporation.

1. *Case 1:* To take advantage of China's low labor costs and export quotas, Taiwanese companies set up intermediary firms in Hong Kong. They established links with the local government of Guangdong and Fujian to set up manufacturing subsidiaries that were tied to the intermediary firms in Hong Kong [39]. These subsidiaries farmed out work to small shops in the surrounding villages. This network provided them with flexibility and enabled them to capture the advantages of costs and locations, benefit from government support services, use several countries as export platforms, and diffuse technology throughout the system [40, p. 173].
2. *Case 2:* Cisco Systems does almost no manufacturing of its own products. Moreover, over 50% of its customer orders via the Internet go directly to its contractors. Also, Cisco handles more than 80% of its orders and customer service

issues over the Web. Cisco customers receive their orders directly from the contractor, and Cisco receives payment for those products. By not being burdened with manufacturing, Cisco concentrates on what it does best: R&D, design, engineering, information, technical support, marketing, and building a reliable network of suppliers [40, p. 182].

With these two examples in the background, we can identify two types of organizations that have used networks: first, those that from a traditional base, by necessity and by the nature of their worldwide operations, have embraced a network structure and, second, those that from the beginning have used a network form to reach the worldwide market. Well-known MNCs such as Nike, Ford, IBM, Toyota, and Cisco Systems are in the first category. Acer, Ispat, Cemex, and Nexia International [40] belong to the second group. (The stories of Acer, Ispat, and Cemex are well documented by a number of authors, including John A. Mathews [2]).

The development of a network organization can be attributed to rapid technological changes, which increased uncertainty and unpredictability. This, in turn, made corporate flexibility a desired characteristic. Globalization magnified the need for flexibility. Firms were forced to abandon vertical bureaucracy in favor of a horizontal-flat design that measured performance by customer satisfaction, which required the maximization of contact with suppliers and the customer and information availability at all levels of the organization.

The network structure is well suited to firms operating in an unstable environment, which requires quick response and innovation. Well-established relations with suppliers and distributors replace vertical integration with the benefit of added flexibility. Spreading business functions all over the world, instead of having them at a central location, exposes the organization to multiple sources of information and new trends. It enables the firm to cope with rapid technological change and increasing globalization of competition.

Sophisticated information technology provides easy access to the global network of suppliers and vendors, even to the smallest firms, at a very low cost. Low-cost information makes vertical integration more expensive as compared with the network, which is more economical. The Internet has reduced the transaction costs of doing business externally instead of relying on in-house suppliers. As formal, hierarchical controls are replaced with informal and personal relationships, internally and externally, the boundaries of firms become porous and permeable. This will lead to a blurring of the line that separates the firm from its suppliers, buyers, and competitors and creates a hospitable condition for the emerging alternative organizational form, the network. Traditionally designed and managed companies cannot operate successfully in such an environment.

With all its versatility, flexibility, and adaptability, some believe that the network structure is inherently unstable and transitional. In a case study of Nexia International, a network of independent public accounting firms, Koza and Lewin [41] came to the conclusion that the network structure is an unstable form. Nexia has more than 100 affiliated independent firms that pool some of their resources to gain access to a wide spectrum of competencies and respond to the global changes in accounting,

auditing, and consulting services. Nexia also enables members to receive referrals from the affiliates, all of which want to remain local. Some affiliates began offering their own services in other national markets, either because of their dissatisfaction with the fees they were receiving due to referral of businesses to other members or because they had gained exposure and experience in the international market. This introduced a potentially disruptive and destructive condition in the network.

It is hard to disagree with the claim that such a network is unstable. But Nexia is a contractual, alliance network, unlike a network built on equity participation and ownership, such as Acer. Established in 1976, Acer is among the world's top 10 branded PC vendors. Acer employs marketing and service operations across the Asia-Pacific region, Europe, the Middle East, and the Americas, supporting dealers and distributors in over 100 nations. In addition to offering a broad spectrum of IT products and services, Acer is also a leading innovator of e-business, providing MegaMicro e-enabling solutions that combine IT products with a range of micro services delivered via Acer's mega infrastructure (<http://global.acer.com/about/index.htm>).

Acer's rapid international expansion into emerging markets began with its becoming a leading IT supplier, partnering with Computec in Mexico and Wipro in India. The partnership arrangement of Acer is not a network of contractual alliances. Mathews [2] describes Acer's self-propagating partnership model, which enables the firm to use an accelerated mode of internationalization through networking, as follows (p. 89):

Step 1: Firm A looks for new markets, forming links with many firms in Countries 2, 3, and 4.

Step 2: In Country 2, Firm A experiments with Firms B, C, and D for reliability.

Step 3: Firm A selects Firm C as a partner and forms joint ventures (JVs) in Country 2.

Step 4: JV AC seeks a new partnership in Countries 5, 6, and 7.

Step 5: JV AC experiments with Firms E, F, and G in Country 6.

Step 6: JV AC selects Firm F to form a new JV, ACF, in Country 6 and then looks for partners in neighboring countries.

Thus, the process of accelerated expansion is propagated from country to country. The network model of Acer, which at the beginning is based on alliances and contractual agreements, ultimately transforms most of the alliances into an equity position.

The astounding performance of East Asian economies during the 1970s and 1980s has prompted much research in comparative organizational theory. This research indicates that the business systems of these countries are mostly network-based, although they are of a different form [2]. These firms do not follow the traditional Anglo-Saxon pattern, embedded in property rights, individualism, and separation of business and government [42].

Networks are either centered on a major MNC or formed on the basis of alliances and cooperation between them. Most economic activities in leading industries are organized around five types of networks [43, pp. 5–6]:

1. *Supplier networks*: These include original equipment manufacturers, the subcontractor, and the links between clients and their suppliers, as well as original design manufacturers.
2. *Producer networks*: These include all involved in co-producing, enabling competing producers to broaden their portfolios by pooling their resources.
3. *Customer networks*: These include the linkage between manufacturing companies and distributors, marketing channels, value-added resellers, and end users.
4. *Standard coalitions initiated by potential global standard setters*: They try to enlist as many firms as possible into agreeing with their propriety product or interface standards.
5. *Technology cooperation networks*: These facilitate the acquisition of product design and production technology. They enable the participants to share generic scientific knowledge and R&D, and production and process development.

Small- and mid-sized firms with their characteristic flexibility seem to be suited for the emerging informational economy. The large companies, however, are still at the center of the new global economy. But the success of small- and mid-sized firms with innovative strategies and organizational structure creates doubts about the value of the traditional model of organization based on vertical integration and hierarchical functional management.

Chapter Summary

Organizational structure is a means and a tool with which the firm can accomplish its goals and implement its plans. The same basic organization design concepts used by domestic firms can be useful for MNCs. To operate on a worldwide basis, however, MNCs need to examine the organizational structures more carefully. Since their organization is spread across the globe, it is only through an effective structure that they can maintain a productive relationship between the various foreign operations and the headquarters.

External environmental conditions and circumstances, along with the firm's characteristics, determine an MNC's proper organizational structure. The MNC's history, top management philosophy, nationality, corporate strategy, and degree of internationalization are attributes that affect the proper choice of an organizational structure. Also, economic conditions, host government policies, product-market characteristics, and information technology are major external forces that influence an MNC's attempts to choose an organizational structure.

(continued)

Five types of organizational structure are commonly used by MNCs. At the early stage of expansion into foreign markets, firms use the international division. When the revenues from foreign sales become a substantial part of corporate earnings and when the firm has gained sufficient international experience, other forms are employed. When an international division is no longer adequate for dispersed MNC operations, product division or geographic division structures are employed. Some firms go through a transition stage before establishing a product or geographic division. In the transition stage, independent foreign subsidiaries handle almost all the MNC's business transactions. A functional organizational structure is used by firms with limited product diversity, such as the raw material extractive industry. Finally, the need for flexibility, coordination, and integration among their worldwide businesses prompts some MNCs to establish matrix structures. Newer forms of organization design, such as market-based designs, SBUs, virtual corporations, and networks, attempt to reduce the drawbacks of the conventional forms but benefit from the flexibility and adaptability that these forms can provide.

Discussion Questions

1. What are the similarities and differences of the organizing needs of MNCs compared with those of domestic firms?
2. Use the product life cycle theory to explain the development of the organizational structure of MNCs.
3. When do MNCs abandon the use of an existing domestic organizational structure and reorganize to support their international expansion?
4. In modifying a domestic organization to handle international operations, what is the most common structure employed by MNCs?
5. Describe the structure of an autonomous foreign subsidiary. What are its strengths?
6. Explain the differences between the structure of an autonomous foreign subsidiary and that of an international division.
7. Elaborate on the conditions that prompt a firm to use the international division structure.
8. Why might a firm with diverse products find a geographic organizational structure inadequate for its needs? What type of organization do you recommend for such a firm?
9. While the functional organizational structure has not been very popular among MNCs, some have used it effectively. Do you think more firms may use it in the future? Elaborate on your answer.

10. What are the advantages of using a matrix structure? Which MNCs benefit from it? How can we minimize the problems associated with using a matrix structure?
11. Discuss in detail two internal and external factors that influence an MNC's choice of organizational structure.
12. What are the differences between a *keiretsu* and a *sogo shosha*?
13. Virtual corporation and network designs differ from the conventional forms. What are their differences?
14. Is it easier or more difficult for a small firm to internationalize?
15. Do you think that small organizations threaten the domination of the global market by large MNCs? Elaborate.

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