

Chapter 1

Multinational Corporations as Networks

The complexity of Multinational Corporations (MNCs) regarding multiple geographical markets and the dispersed activities within the company often renders centralised management models ineffective and inefficient. Knowledgeing the increased relevance of foreign subsidiaries and the observation that some subsidiaries assume strategic roles within the MNC lead to a conceptualisation of the MNC as a network. In this Chapter, the network perspective of the MNC is explained, nodes and linkages in the network are described and the contribution of this perspective to understanding the modern MNC is demonstrated.

From Centralised Hubs to Integrated Networks

From the early 1980s, the limitations of hierarchical models of the company with regard to their capability to manage the complexity of a Multinational Corporation (MNC) became obvious in the course of increasing internationalisation, the emergence of more and more MNCs, and the constantly rising relevance of foreign subsidiaries. Studies by scholars such as Prahalad, Doz, Bartlett and various others revealed that top management in the home country had more and more problems in effectively and efficiently processing and understanding the vast amount of information necessary to coordinate the MNC.

MNC management is confronted with the challenge of designing systems that allow flexible responses to the very heterogeneous context in which the different subsidiaries have to compete. It is also necessary to sense the diverse opportunities and demands that the MNC faces, and to simultaneously ensure the necessary coherence to act as one company, to achieve global scale effects by specialising their subsidiaries' activities and to exploiting synergy potential. In a sophisticated and differentiated configuration of specialised assets and responsibilities, the interdependence of worldwide units increases, and an *integrated network structure* becomes necessary to coordinate the dispersed activities. In this network model, management regards each of the worldwide units as a potential source of ideas, skills, capabilities, and knowledge that can be used to benefit the entire organisation. Efficient local plants may be converted into production sites with worldwide responsibility, and innovative organisational units may become the MNC's centres of competence for a particular product or process (Bartlett/Beamish 2014, pp. 284-285).

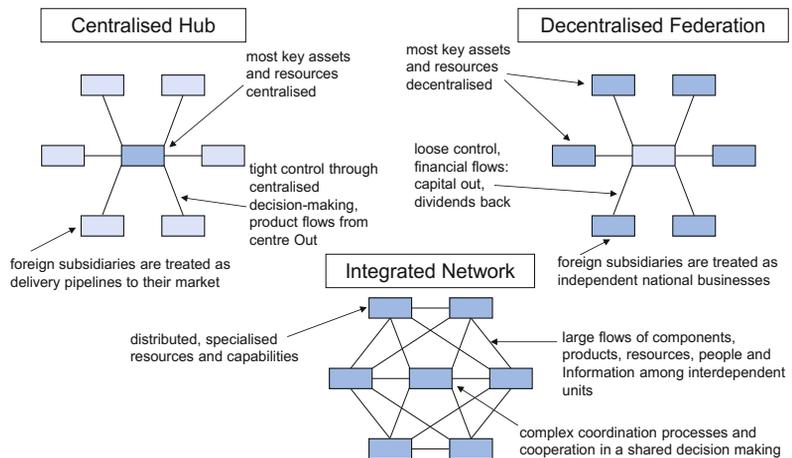
*The Integrated
Network Model*

*From
Dependence or
Independence to
Interdependence*

To understand this modern type of network model better, Figure 1.1 contrasts it with two alternative models, the *centralised hub*, a traditional model in which the foreign subsidiaries merely implement central decisions and have no autonomy, and the *decentralised federation*, a multinational model with great autonomy of the subsidiaries, but only weak linkages within the MNC, which acts mainly as a holding company. While national subsidiaries in decentralised federations enjoy considerable *independence* from the headquarters, those in centralised hubs remain strongly *dependent* on the parent company. Integrated networks are *interdependent* organisations, with dispersed, and specialised, but coordinated interrelationships between the units. Such networks result in a so-called *decentralised centralisation* i.e., the activities are globally integrated and aligned. Subsidiaries are not necessarily coordinated by the headquarters but in some cases and for some products, by another foreign subsidiary (Birkinshaw/Morrison 1995, p. 734).

Figure 1.1

Alternative Models of the MNC



Source: Adapted from Bartlett/Beamish 2014, p. 281, p. 285.

*Many Network
Models*

From the 1980s onwards, more and more scholars started to model the MNC as a *network*. The “transnational organisation” (Bartlett/Ghoshal 1989), the “heterarchy” (Hedlund 1986), and the “differentiated network” (Nohria/Ghoshal 1997) are just a few examples. While there are many differences in detail, all these models recommend organising the MNC as an integrated network of dispersed organisational units.

Networks consist of *nodes* (in this case mainly foreign subsidiaries) and *linkages* between those nodes (like coordination relationships, product flows, communication, etc.). Some of the nodes, i.e. of the foreign subsidiaries, achieve – due to unique resources, capabilities and competences, for example – a crucial influence on the decisions of the MNC and foreign subsidiaries can assume “strategic roles” (see Chapter 3). Competitive advantages of the MNC are not necessarily developed in the home country any longer and then transferred and exploited in foreign countries, but can be established by single foreign subsidiaries or through cooperation in the whole MNC network. *Learning* becomes necessary to create and diffuse knowledge quickly within the MNC (Schmid/Kutschker 2003, pp. 163-164).

Heterogeneity between Foreign Subsidiaries

The network perspective of the MNC acknowledges that foreign subsidiaries are and should be heterogeneous: “to be truly effective, multinational corporations should be differentiated” (Nohria/Ghoshal 1997, p. xv). Looking at the British MNC *BP*, which is described in detail in the case study at the end of this Chapter, one can see that the company is active in more than 80 countries. Some foreign subsidiaries (e.g. in Iran) were established more than 100 years ago, but others are just a few years old. Some foreign subsidiaries mainly carry out, for instance, oil exploration, while others focus on distribution (e.g. selling fuel via a network of gas stations). Some only employ a few people, while in the UK, the company has about 10,000 employees. Some work in slow-growing countries of Western Europe, others in fast-growing emerging economies like India. Some are wholly-owned and some are operated in partnerships with other companies.

The *BP* example demonstrates that subsidiaries can be distinguished by many different criteria. Heterogeneous characteristics of subsidiaries include, inter alia (Morschett 2007):

- value-added activities carried out by the subsidiary, extend from single activities (e.g. only sales) to full value chains
- dominant motives for the establishment of the country subsidiary, for example, resource seeking or market seeking (see Chapter 4)
- available resources and capabilities of the subsidiary
- local conditions of the host country, e.g. political and economic situation
- degree of horizontal and vertical product and communication flows with other subsidiaries and the headquarters
- control and influence of the headquarters

Multinational Corporations as Networks

- national, regional or worldwide responsibility of the subsidiary
- age of the foreign subsidiary or time frame of belonging to the MNC (in the case of an acquisition)
- size of the subsidiary (sales, employees, financial assets, etc.)
- performance of the subsidiary.

The role typologies of International Management (see Chapter 3) are an attempt to categorise subsidiary roles following some of these characteristics.

Subsidiaries as Centres of Excellence

Network models also assume that subsidiaries can become “centres of excellence” (or *competence centres*) for the MNC. A centre of excellence is “an organizational unit that embodies a set of capabilities that has been explicitly recognized by the firm as an important source of value creation, with the intention that these capabilities be leveraged by and/or disseminated to other parts of the firm” (Frost/Birkinshaw/Ensign 2002, p. 997). Studies have shown that most MNCs have foreign subsidiaries adopting the role of centres of excellence (Schmid/Bäurle/Kutschker 1999, pp. 108-109). Such centres of excellence play a highly strategic role in the MNC network.

High Autonomy and Strong Integration

A high level of competence is an obvious prerequisite for this role and centres of excellence are characterised by simultaneous appearance of *high autonomy*, because a relatively high degree of freedom is necessary to deploy its competences effectively, and *strong integration* in the MNC to ensure that the competence is available to other country subsidiaries as well (Forsgren/Pedersen 1997). Centres of excellence can concern products or processes or functions of the MNC (Frost/Birkinshaw/Ensign 2002, pp. 998-1000). It becomes increasingly obvious, though, that the concept of a centre of excellence is not an all or nothing situation, but rather a continuum, i.e., each subsidiary may act to a certain (but different) level as a centre of excellence within its MNC.

Flows in the MNC Network

The network perspective of the MNC illustrates it as a combination of nodes and linkages. Those linkages include potential superordination and subordination in the headquarters-subsidary relations and coordination relationships that might be more or less centralised. Sometimes, coordination might not be achieved through the corporate headquarters in the home country,

but rather from a superordinate subsidiary that acts as the regional headquarters.

Linkages in the network also encompass a number of different transactions among units located in different countries. Hence, the MNC can also be thought of as a *network of capital, product, and knowledge flows* between organisational units (Gupta/Govindarajan 1991, p. 770). In the network perspective, it becomes evident that, *instead of unidirectional flows* of products, components and know-how from the headquarters to the foreign subsidiaries, there are *bidirectional and reciprocal flows* and interdependencies. Not only are there *vertical linkages* between the headquarters and each subsidiary, but increasingly, there are *horizontal relations* between the subsidiaries, concerning both product flows and employees and knowledge exchange.

For example, a French sales subsidiary of the German car manufacturer BMW mainly receives product inflows, while the German factories exporting to other countries are a source for product outflows. The US factory of BMW which sells its vehicles to Mexico demonstrates horizontal product flows. In cross-border production processes (see Chapter 19), components are produced in different countries and often transported to a subsidiary that assembles the finished products. Similarly, dispersed R&D activities and innovation processes are only possible through substantial vertical and/or horizontal knowledge flows (see Chapter 20).

Generally, these flows within the MNC may have different magnitudes and different directions, and the transactional perspective increases the number of potentially heterogeneous characteristics of MNC subsidiaries, since substantial differences across subsidiaries within the same MNC will exist. The role typologies (see Chapter 3) attempt to capture some of these differences systematically.

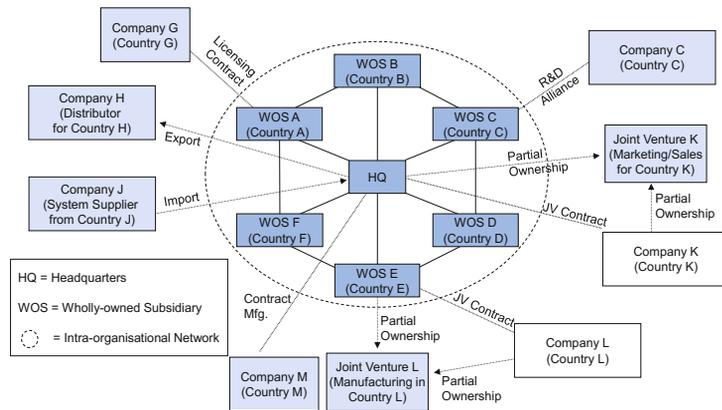
Intra- and Inter-organisational Networks

As mentioned in the introductory section, MNCs comprise entities in two or more countries, regardless of the legal forms and fields of activity of those entities. It is not relevant what legal form the entity has, but only that “active, coordinated management of operations in different countries, as the key differentiating characteristic of a MNE” (Bartlett/Beamish 2014, p. 3) is possible. An MNC must own or control value-adding activities in more than one country (Dunning 1993). Given that *subsidiary* is defined “as any operational unit controlled by the MNC and situated outside the home country” (Birkinshaw/Hood/Jonsson 1998, p. 224), foreign subsidiaries are not necessarily wholly-owned. The enormous relevance of cooperative operation modes (see Part IV of this book), like licensing, joint ventures, franchising,

*A Network of
Capital, Product
and Knowledge
Flows*

etc., necessitates the inclusion of these internationalisation modes in the conceptualisation of an MNC.

Figure 1.2 The MNC as an Intra- and Inter-Organisational Network



Source: Adapted from Schmid/Kutschker 2003, p. 165.

As an example of the potential complexity, Figure 1.2 illustrates the MNC network, consisting of wholly-owned subsidiaries and other foreign activities that are closely linked to the company, by partial ownership, contracts or otherwise.

Increasing Relevance of Inter-organisational Networks

*From Market
Capitalism to
Alliance
Capitalism*

Thus, it is not only the company itself that is more and more structured as a network. Networks, as *stable relational systems* between different organisational units, have grown tremendously in relevance over the last few decades. Cooperative arrangements between companies are becoming very common, and some authors have called this a change from “market capitalism” to “alliance capitalism” (Dunning 1997).

*Cooperation as
Hybrid
Operation Modes*

Cooperation, as hybrid arrangements between the transaction forms of “market” and “hierarchy”, seem to combine the advantages of both extremes and help to compensate for the weaknesses of both (Das/Teng 1999). Bartlett and Ghoshal, who originally developed their network model with the perspective of a purely intra-organisational network, recognised later that this perspective is too narrow and has to be expanded to include the inter-

organisational network (Ghoshal/Bartlett 1991). This perspective acknowledges that the MNC is involved in *strategic alliances* with other companies.

Blurry Boundaries of the MNC

With this perspective, however, the idea that an MNC has clearly defined boundaries becomes disputable (Nohria/Ghoshal 1997, p. 19). While one could merely see the external network (inter-organisational) as an extension of the internal (intra-organisational) network, a clear separation between both becomes almost impossible (Morschett 2007). For example, while a close and long-time customer would usually still be regarded as part of the inter-organisational network, a 95%-owned foreign company would usually be seen as part of the intra-organisational network. Whether majority-owned subsidiaries, parity joint-ventures or contract manufacturers that manufacture a company's product with a fixed long-term contract are "internal" or "external", cannot however be stated categorically. One could even argue that MNC networks like this do not even have clearly defined boundaries (Hakansson/Johanson 1988, p. 370). A "*boundaryless corporation*" (Picot/Reichwald/Wigand 2003) might well be the consequence.

However, for practical reasons, it is frequently necessary to define the boundaries, but this is necessarily subjective and depends on the purpose of the exercise. Some authors suggest that the *perceived identity* of the organisational units might be decisive: "We argue that normative integration is the glue that holds differentiated networks together as entities called firms. [...] it is the distinctive codes of communication shared by the members of the multinational that truly demarcate the boundaries of the organization" (Nohria/Ghoshal 1997, p. 6).

Corporate (Internal) and Local (External) Embeddedness

If, for analytical reasons, one still tries to distinguish between the internal and the external network, a foreign subsidiary is linked to the MNC headquarters and to other subsidiaries, i.e. to the internal or corporate network.

Furthermore, the local network of the foreign subsidiary is relevant. Critical resources of the subsidiary are linked to the subsidiary's specific relationships with customers, suppliers and other counterparts (Andersson/Forsgren 1996). This local network is a powerful resource and often plays an equally strong role for the operative activities of the subsidiary and even for the strategic competitiveness of the subsidiary, as part of the relationship with the rest of the MNC. Regarding, for instance, the know-how that is relevant for the subsidiary, not only the knowledge transfer from the rest of the MNC, e.g. from the headquarters is important, but also the ques-

*Local Network
as Resource*

tion of how new, locally relevant knowledge is created within the subsidiary. Here, the external, local network of the subsidiary is a strategic source for subsidiary-specific advantages. These “network resources” of each subsidiary can enhance the competitiveness of the MNC as a whole, because they influence the competitiveness of each subsidiary in its local market and also – by transferring of knowledge to peer subsidiaries – the capabilities of the company network (Andersson/Forsgren/Holm 2002). As mentioned above, the presence in heterogeneous local contexts can be seen as a basic advantage of MNCs, compared with purely national players. Thus, one can also consider *the foreign subsidiary as an important connection, a “linking pin”,* between the external, local network in a host country and the internal company network (Andersson/Forsgren/Holm 2002, p. 992).

Embeddedness

To work successfully in a network, each subsidiary is *embedded* in relationships with other actors (Andersson/Forsgren 1996). This basically refers to an adaptation of the resources of the subsidiary to its specific network, i.e. other network actors. The adaptation includes specific investment, technical adaptations of production processes, adaptations of the product design, etc. This embeddedness must occur regarding the local network in the host country (“local embeddedness”), but also for the linkage of the subsidiary to the rest of the MNC, i.e. to the intra-organisational network (“corporate embeddedness”). However, this *dual embeddedness* might lead to conflict. The subsidiary is exposed to *different internal and external stakeholders* who usually try to influence its behaviour in accordance with their own interests. Different contexts can lead to tension, which creates a *dilemma* within the MNC. A strong local embeddedness of the subsidiary can enhance its competitiveness and also the knowledge creation of the MNC in total. Furthermore, the local embeddedness enhances the absorptive capacity of the subsidiary for new local knowledge. However, this local embeddedness often reduces the embeddedness in the corporation and thus diminishes the potential influence of headquarters (Andersson/Forsgren 1996).

Tension between Local Environment and Corporate Integration

Ultimately, this dilemma is a consequence of the basic challenges for an MNC, and captured particularly in the discussion of the integration/responsiveness-framework (see Chapter 2). Greater responsiveness to local conditions and stronger internal integration are potentially two forces in tension that have to be optimally resolved in the MNC.

Coordinating the MNC Network

With increasing complexity of the MNC, and the dual tendency to disperse activities to differentiated subsidiaries around the world, with simultaneous competitive pressure to coordinate these widespread activities, managers recognise that the organisational structure is insufficient to manage the chal-

lenging tasks facing the network. In addition to the formal structure of the company – which is still a powerful instrument – other instruments, including processes, communication channels, decision-making loci and interpersonal relationships become necessary for coordination. In particular, more subtle and informal coordination mechanisms are seen as relevant for coordinating MNC networks (Martinez/Jarillo 1989, p. 489).

The Structure of the MNC as a Differentiated Network

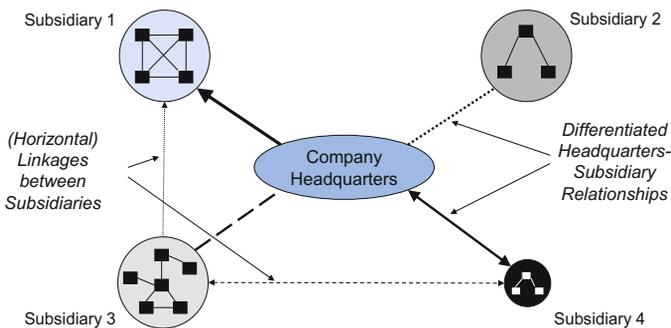


Figure 1.3

Source: Adapted from Nohria/Ghoshal 1997, p. 14.

One shortcoming of the company's organisational structure as a means of coordinating the MNC lies in heterogeneity. All subsidiaries are confronted with the same MNC structure, but within a differentiated network, "variations within such MNCs can be as great as variations across them" (Nohria/Ghoshal 1997, p. 12).

Subsidiaries, as mentioned, have different tasks, resources and competences. They also have different internal structures. Thus, as shown in the model of the integrated network, horizontal linkages between subsidiaries emerge and they are beneficial. Direct horizontal links between subsidiaries, however, make central coordination from the headquarters even more complicated. In all, the *headquarters-subsidiary relationships* must be heterogeneous as well. Stronger centralisation of decisions for certain subsidiaries and more autonomy for other subsidiaries might be sufficient. Formal and standardised procedures might be well suited for production subsidiaries but counterproductive for R&D subsidiaries, and so on. Thus, flexible and more complex coordination mechanisms become necessary. Frequently, the delegation of decision-making power to dispersed organisational units is suggested, in combination with coordination via a strong corporate culture, i.e. *normative*

Complex and Differentiated Coordination

Persisting Important Role of Headquarters

integration (Bartlett/Ghoshal 1987; Buckley 1996, p. 32). To stimulate horizontal transactions between subsidiaries, informal communication by means of creating of a network of personal and informal contacts among managers across different units of the company is seen as crucial. Generally, in order to implement complex strategies that result from interrelated, multiple-country, specialised activities around the world, an enormous coordination effort is needed. Thus, all types of coordination instruments, formal and structural, plus informal and more subtle mechanisms, are needed (Martinez/Jarillo 1989, p. 492). The different coordination mechanisms are discussed in more detail in Part III of this book.

However, even in the model of the differentiated network, headquarters still exist and have a somewhat hierarchical position in the network. While the heterarchical models have become prominent, most empirical studies still reveal greater a higher power in the headquarters, mostly in the home country. The network model in its extreme, i.e., a network of equally powerful organisational units with extreme decentralisation of strategic decisions to different subsidiaries and no hierarchical power in the centre, is *more of an ideal-type* in the literature than a common phenomenon in reality (Morschett 2007). “Notwithstanding the fact that MNCs are indeed becoming ‘heterarchies’ [...] i.e., integrated complex networks with significant devolution of authority and responsibility to the subsidiaries, the parent corporation continues to serve” (Gupta/Govindarajan 2000, p. 483) at least as a *primus inter pares*, and usually as the strongest unit concerning knowledge generation, decision power, etc.

Conclusion and Outlook

Originally, the network perspective was only used for a specific type of MNC model, in which all foreign subsidiaries have relatively high autonomy, specialised assets and competences which they leverage for the total MNC (see Figure 1.1).

Every MNC is a Network

It becomes evident, however, that many elements of a network, including relationships with internal and external actors, some degree of horizontal linkages and specialised tasks, some heterogeneous characteristics of the subsidiaries and transactional exchange between different organisational units in different countries, are not features of a specific MNC type but, to some degree, of all MNCs. One can thus conclude that “every MNC is a network” (Gupta/Govindarajan 2000, p. 491), even if it may, in many cases, still be reasonable to concentrate some key resources and capabilities in the home country. In any event, the network perspective is very useful for understanding the MNC.

Case Study: British Petroleum*

Profile, History, and Status Quo

In 1901, the English entrepreneur William D'Arcy acquired an exclusive right to search for oil in South-West Persia (modern Iran). After years of unsuccessful searching, in 1908, the chief explorer Reynolds announced in a telegram sent to D'Arcy, who was about to go bankrupt, an immense oil discovery. The *Anglo-Persian Oil Company* started business within a year and would become *British Petroleum (BP)* in 1954.

With the rise of the automobile, *Anglo-Persian* expanded its business to the mainland of Europe and the USA in the 1920s and 1930s. Thus, the number of *BP*-labelled petrol pumps or service stations increased from 69 in 1921 to more than 6,000 in 1925. In the post-war era, *Anglo-Iranian* invested mainly in refineries and new marketing efforts in Europe. It took the company several years to find new large oil reservoirs – in 1969 on the Prudhoe Bay in Alaska and in 1970 offshore in the North Sea. Those discoveries were crucial to the survival of *BP*, because almost every oil-rich nation in the Middle East, including Iran where the company once concentrated its complete strategy, was about to nationalise its resources. Hence, *BP* learnt its strategy lesson with regard to configuration for the future. Over the last few decades, *BP plc.* grew into one of the largest vertically integrated energy groups in the world.

A dramatic event in 2010 changed the future of *BP* and put its existence at risk. On April 20th, 2010, a gas release and subsequent explosion occurred on the Deepwater Horizon oil rig working for *BP* in the Gulf of Mexico. Eleven people died as a result of the accident. For three months, the oil well spilled enormous amounts in the sea. It is now estimated that more than 3 million barrels of oil were released; the accident is one of the largest environmental disasters ever. Enormous costs for *BP* are the consequence. The company has to compensate and participate in measures to limit the environmental impact, including fighting the spill, removing and dispersing the oil offshore, protecting the shoreline and clean-up activities of the oil that came ashore. Legitimate claims by local businesses (e.g. fishermen), individuals, government agencies, etc., have to be fulfilled. A trust has been set up with a value of 20 billion USD to make sure that the funds are available in the long-run.

*First Oil
Discovery of
Anglo-Persian*

Rise of BP

*Deepwater Horizon
Oil Spill*

* Sources used for this case study include the corporate websites and various annual reports, investor-relations presentations, as well as explicitly cited sources.

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*Divesting 50
Billion USD
of Assets*

*Second Largest
Company in the
UK*

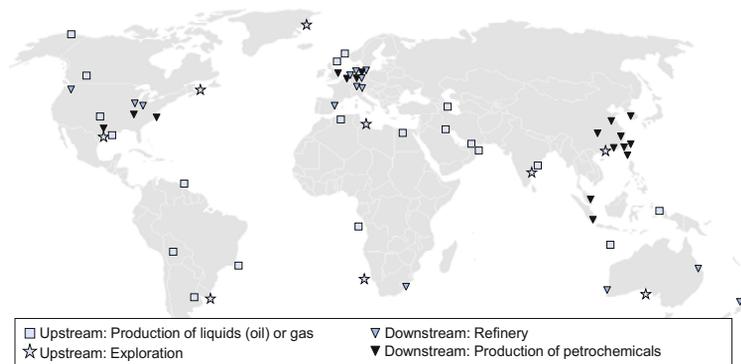
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After the oil spill, *BP* announced a huge divestment programme to compensate its liabilities related to the accident. By spring 2014, the company had completed the sales of assets of 38 billion USD and announced a further 10 billion USD divestment to be completed by the end of 2015. Thus, within less than 5 years, *BP* drastically downsized and it will have carried out a divestment of almost 50 billion USD.

Still, with revenues of 390 billion USD in 2013, more than 80,000 employees, and operations in 80 countries, *BP* today is one of the largest MNCs in the world and the second largest British company with a stake of 19.75% in the Russian giant *Rosneft*. It maintains an extensive network of exploration, production, refining and sales operations worldwide (see Figure 1.4).

Figure 1.4

Geographic Spread and Functional Diversity of BP's Worldwide Operations (as of Dec. 31, 2013; without Operations of Rosneft)



Source: BP 2014a, pp. 4-5.

*BP's Vertical
Integration*

The Value Chain of BP

BP is a vertically integrated, globally distributed company network. It has operations in all stages of the oil and gas value chain, including the exploration and extraction of crude oil and gas, the transportation and trade in oil and gas, the manufacturing stage, including refining of fuels, lubricants and petrochemicals, and, ultimately marketing and sales activities which involve selling the refined petrol through almost 18,000 service stations globally (see Figure 1.5). Usually, the first two stages in the value chain are categorised as “upstream” activities, the last two stages are seen as “downstream” activi-

ties. The midstream activities are, in the organisation of *BP*, combined with the upstream activities.

Value Chain of BP

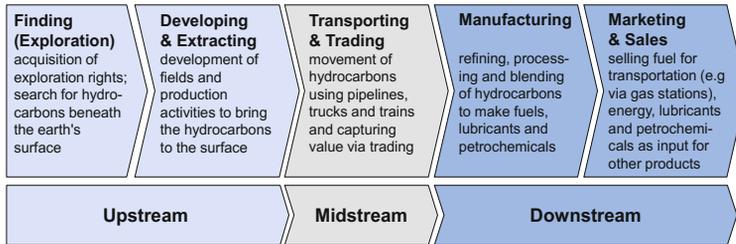


Figure 1.5

Source: Adapted from BP 2014a, pp. 2-3.

From the above value chain, it already becomes evident that the *multinational network* of *BP* is highly heterogeneous and that the different activities in the different stages have very different requirements:

- The configuration of *upstream activities* is strongly determined by where the natural resources are found and where they can be exploited most profitably. The locations are often in developing countries and in politically unstable environments. Concerning the external partners, these are often state-owned or at least with close relationships to the respective governments who tend to keep a strong influence on their energy reserves.
- Concerning the *downstream activities*, the configuration is strongly influenced by demand patterns. For fuel, for example, the countries of Europe and the USA are important sales markets. Since these activities need to be carried out close to the market (e.g. via networks of service stations), they are often also done in partnerships, e.g. via franchising. Similarly, petrochemicals which are used as inputs for other products are mainly sold in the industrialised countries.
- These two differing selection criteria for the locations for upstream and downstream activities manifest themselves in a *wide-spread company network*. Midstream activities are needed as *links* between those locations. Their geographic locations are therefore almost predetermined, but *BP* does not necessarily have to carry out those activities itself. Huge logistics companies have fleets of tankers that distribute oil worldwide. However, it is in particular where highly specific assets are necessary (see

Following Natural Resources

Following Customers

Linking Upstream and Downstream

Chapter 6 for the explanation of *asset specificity*), that *BP* has to invest itself in the midstream activities, e.g. with pipelines which connect oil and gas fields which are exploited by *BP* to customers or ports.

Upstream - Exploration and Production

International Sourcing

The oil industry is an example of how the access to natural resources is a main influence factor on the company's configuration. Today, the proved oil reserves are spread around the world (with a dominant part in the Middle East).

Country Risks

One can see until today that the country risks that accompany doing business in unstable political regions can even lead to state expropriation or the danger thereof. This was the case in the early 1970s when *Gaddafi* came to power through a military coup in Libya and nationalised *BP*'s oil operation. In 2008, *BP* struggled with its Russian joint venture *TNK-BP*. Here, the Russian shareholders had tried to take control of the company, and it seemed that the administration in Russia was joining forces with the Russian oligarchs against *BP*. Still, in resource-rich countries, *BP* needs to pursue strategic alliances with such local partners. Nowadays, in countries like Russia or Azerbaijan, these are often state-owned companies. Another mutual benefit of collaboration is that the huge investment risks (with very late pay-offs), which are often associated with those projects, can be shared.

Change in Strategy since 2010

The accident in the Gulf of Mexico has led to a substantial reorganisation and reconfiguration of *BP*'s upstream business. The recent strategy of *BP* in this respect is "value over volume". For example, this meant divesting many non-core assets in the upstream portfolio and maintaining in particular those in which *BP* has particular capabilities, e.g. in deepwater oil reserves. Since 2010, *BP* has reduced its operated installations worldwide by more than half and the operated wells by 35%. Geographically, this meant refocusing on larger units. For example, *BP* has divested many of its smaller upstream operations, e.g. in Vietnam or Columbia. The main objective is to reduce the network "by focussing our investment into the key regions that are also the higher margin regions of our portfolio" (McKay 2014). This means reducing the exposure to low-margin assets and keeping the more profitable ones. The investment focus of *BP* in its upstream projects and operations is now on four key regions: Angola, Azerbaijan, the Gulf of Mexico and the North Sea.

Separating the Onshore Business in the USA

Another major strategic change was recently announced. In March 2014, *BP* informed the public that it would "separate" its US onshore oil and gas business, the so called "US Lower 48". This mainly refers to the shale oil and shale gas business, a technological innovation which drastically changes the

business. *BP* faces a dilemma in this business: Participating in the shale oil and gas exploitation is important for the long-term upstream strategy, because “Lower 48 will remain at the forefront of innovation, and drive global learning in unconventional for the foreseeable future” (McKay 2014). “Unconventional” gas reserves are basically synonymous with shale reserves. However, currently, this business is not very profitable for many of the larger oil companies. An analysis has shown that *BP* underperforms in this activity, partly because of its corporate structure and processes. Many players in this part of the industry are smaller, independent companies which are able to move and decide quicker than a large MNC as *BP*. Separating the management for the US onshore business, including different governance processes, would allow it to compete better, because it could improve speed of innovation and decision making. The business should, though, still remain part of *BP*'s network (Dudley 2014; McKay 2014). Outside observers have a more critical perspective on this separation. They argue that *BP* has the declared objective to become smaller and more profitable. Thus, separating the operations could, at least at first sight, increase the profit margin of the remaining *BP* activities. The separation even raises the question of whether this could be a step towards divesting these operations (Scheck/Fowler 2014).

Midstream - Efficient Bridges from Production to Refining

To connect the production locations of gas and oil with the refineries, the hydrocarbons need to be transported. This is done via different transport mechanisms, often pipelines. Such pipelines are huge projects, often running across different countries and of high economic and political relevance to these countries. One example of such a pipeline is the 1,768-kilometre *Baku-Tbilisi-Ceyhan Pipeline* (BTC) from Azerbaijan at the oil-rich Caspian Sea through Georgia and Turkey to a terminal at the Turkish coast that commenced operation in 2005. The *BTC* pipeline was a challenging engineering project justified by the aim of bypassing the politically unstable territories of Russia and Iran – a cost-efficient and reliable logistic to the Western markets. The pipeline is owned by a consortium of several oil producers; the largest shareholders are *BP* (with about 30%) and the *State Oil Company of Azerbaijan* (*SOCAR*) with 25%. It is operated by *BP*.

In Alaska, an agreement for another major midstream project was signed in 2014. This project is so big that it needs the involvement of several companies. For a feasibility study in the so-called “*Alaska LNG export project*”, *BP* works together with *ExxonMobil* and *Conoco-Phillips* who also own gas fields in Alaska, the pipeline company *TransCanada* and the *State of Alaska* to analyse the possibility to commercialise Alaskan gas through “liquified natural

Pipelines as Joint Projects

Liquified Gas from Alaska

gas". This project would require building a massive plant to cleanse the produced gas in the vicinity of the gas fields, almost 900 miles of pipeline across Alaska to Nikiski and then the construction of a liquefaction plant, storage facilities and a tanker terminal. The estimated costs for the project are between 45 and 65 billion USD. Again, several companies and – as often in the case of natural resources – the state are involved.

Downstream - Refining and Marketing

BP not only concentrates on finding and extracting oil and gas but also on extending its business down the value chain to refining oil, marketing and distributing petrol and other products to the consumer. Since the Second World War, BP has invested heavily in international sales expansion. Moreover, within what was long its second major business segment for a long time, investments in *refineries* in Germany, but also in France and Italy were undertaken. To further expand its downstream business, BP sought several large M&As. In 1987, the company acquired the remaining shares of *Sohio*, an American oil company with refineries and a service station network, which was incorporated into *BP America*. In 1998, BP merged with *Amoco* to deal with the tough competition by combining their global operations and hence, the largest producer of oil and gas in the USA was formed. Soon, *Amoco's* service stations were re-branded as *BP*. Furthermore in 2000, BP was joined by *ARCO*, an American oil company with a large network of pipelines, chemical plants, refineries and over 900 outlets trading as "*ampm*". Thereafter, all service stations of the *BP Group* on the West side of the Rocky Mountains were branded as *ARCO*. However, in the course of its divestment programme, *ARCO* was sold in 2013 to *Tesoro* from Texas, a refiner and marketer of petroleum products in the Western part of the USA.

Castrol, a producer of lubricants especially for automotive and aeroplane engines, has belonged to the *BP Group* since 2000. *Aral*, with its very modern service station network, became part of the *BP Group* in 2002 and BP decided to keep the *Aral* brand. The 630 German BP stations were rebranded with the familiar *Aral* blue and white.

Service Stations Often in Alliances

BP now concentrates many of its activities in Europe and the USA on these main brands. The company was also looking for new markets, however, and now operates 850 retail stations in China, in joint ventures with its local partners *Sinopec* and *Petrochina*. In marketing and distribution, joint ventures and alliances are very common. In the UK, as another example, BP works in a partnership with *Marks & Spencer*. This retail company has opened 170 of its "*Simply Food*" stores at BP forecourts to combine the strengths of an extensive roadside network of BP with those of a well-known retailer. In many other countries around the world, the gas stations through which BP sells

fuels are operated by franchisees, independent entrepreneurs who are allowed to use the *BP* brand and adhere to the *BP* brands and standards. In all, there are 17,800 retail stations operated under the different *BP* brands worldwide, but many of them not by *BP* itself.

A major move in *BPs* downstream business is the divestment of refineries. Since 2000, *BP* has sold 13 refineries, reducing its capacity by almost 40%. It now only operates nine refineries and five joint venture refineries, which are operated by remaining partners. This is part of the strategy to increase the corporate profit margins, since the refining stage is relatively less profitable than the marketing stage. In fact, *BP* now follows a *refining deficit strategy*. It outsources its refining activities to others, reducing its own level of vertical integration and thus enters into even more crucial network partnerships.

*Moving Towards
a Refining Deficit*

Partnerships of BP

As *BP* itself points out, companies in the oil and gas industry must have a broad *network* of close business partnerships. Impressively, in 2013, 54% of the 373 million hours worked by *BP* were carried out by contractors. Concerning the coordination of this network, *BP's* operating management system includes requirements and practices for working with contractors and the company expects its contractors to adhere consistently to *BP's* code of conduct when they work on *BP's* behalf (*BP* 2014b). The strategy to develop deeper, longer-term relationships with fewer partners is relatively new.

Contractors

Furthermore, *BP* operates many different joint ventures with different levels of shareholding in them which in turn determine its influence or control over the joint venture. When *BP* operates the joint venture, its operating management system applies to the operations of the joint venture as well. However, about 46% of upstream production and 13% of its refining capacity in 2013 were from joint ventures for which *BP* is not the operator (*BP* 2014b).

Joint Ventures

The Minority Stake in Rosneft and a Conflict within the Network

Since 2003, *BP's* operations in Russia were conducted via the joint venture *TNK-BP* with a consortium of Russian partners, *AAR* (*Alfa Group*, *Access Industries*, *Renova*). This was a major part of *BP's* global network, representing almost one fourth of *BP's* production and one fifth of its total reserves in 2007. The conflicts within the joint venture have been mentioned above, but eventually they were resolved. However, in 2011, a new, critical problem emerged. *BP* was intending to close a mega-deal with the Russian oil giant *Rosneft* to explore the oil reserves in the Arctic region. But *AAR* managed to

*One Joint Venture
with 25% of BP's
Business*

block this deal through a British court because these activities would have compelled with the *TNK-BP* operations. *AAR* rightfully claimed that *BP*'s proposed rival joint venture with *Rosneft* would have breached the shareholder agreement governing *TNK-BP* (Webb 2011). This demonstrates the potential conflicts within company networks and potential networks.

Getting a Stake in Rosneft

One year later, *Rosneft*, which is said to be controlled by the Kremlin, announced that it would take over *TNK-BP* from its owners. The deal was completed in spring 2013. *Rosneft* paid *AAR* in cash for their half of *TNK-BP*, 27.7 billion USD. *BP* received 12.5 billion USD in cash and 18.5% *Rosneft* shares. Including the previously owned shares, *BP* now holds 19.75% of *Rosneft*, today the largest oil producer in volume in the world. The relevance of this minority stake (and, thereby, making *Rosneft* a node in *BP*'s international network) for *BP* is very high:

New Future in Russia

- Given the enormous relevance of the reserves in Russia, the CEO of *BP*, Bob Dudley, called the completion of the deal with *Rosneft* a “New Future in Russia” (Dudley 2014, p. 10).
- Without *Rosneft*, *BP* has dropped in the international ranking of oil producers to No. 5, with 2.3 million barrel per day (and 11.4 billion barrels of proved reserves). Together with the stake in *Rosneft*, *BP* is still the No. 2 in the world with 3.2 million barrel production per day and 18 billion barrels of proved reserves. Thus, via this network partner, *BP* has increased production by 40% and its proved reserves by almost 60%.
- With this strategic alliance and ownership, *BP* hoped for a preferential treatment and more exclusive deals with *Rosneft* in Russia. However, in the first year after the deal, *Rosneft* has signed a number of agreements with other major oil companies which caused some disappointment among *BP* shareholders.

Joint Venture with Rosneft Amidst Sanctions

However, this changed in May 2014, when *Rosneft* and *BP* signed an exclusive agreement to explore “unconventional oil” in Central Russia in a joint venture which is owned 51% by *Rosneft* and 49% by *BP*. Moscow is hoping to replicate the shale oil boom from the USA and to be able to exploit its own reserves. As *Reuters* (2014) reported *BP*'s CEO Dudley saying: “President (Putin) has urged us today to invest into shale oil”. Furthermore, it is noteworthy that the signing of the agreement happened amidst the sanctions against Russia following the annexion of the Crimea. *Rosneft*'s CEO Igor Sechin is personally being targeted by US sanctions because he is a close ally of President Putin. Putin himself attended the signing ceremony.

Summary and Outlook

BP is one of the largest MNCs in the world, but now finds itself in midst of drastic change with continued enormous divestments, restructuring and focusing its worldwide activities – risk management in particular, of the upstream business.

BP has a global network of subsidiaries with different roles for the company, often focusing on one part of the value chain. Some of them are for oil or gas exploration, some of them are dedicated to refining or transporting oil or gas, and some focus on the sale of fuels via gas service stations. Many of these activities are carried out in partnerships with are institutionalised in different modes. Ranging from consortiums with other oil companies (for example, the BTC pipeline) to a minority stake in one of the largest companies in the world, *Rosneft*, to many joint ventures which are operated by *BP* or by other partners and other contractual relationships for the production or refinery of hydrocarbons – the case of *BP* clearly demonstrates how the activities of a modern MNC are carried out within a network of wholly-owned subsidiaries, partly-owned subsidiaries and external partnerships.

Questions

1. One of the major strategic moves of *BP* in the last few years was the transition with *Rosneft*, giving the company access to huge oil and gas reserves in Russia. Discuss the benefits, disadvantages and risks of this partnership.
2. In 2003, the joint venture *TNK-BP* was formed, which is an example of all the challenges associated with the petroleum industry in a politically unstable country. Describe and analyse the problems that *BP* was experiencing with this Russian engagement.
3. To sell fuel, *BP* has gas stations in many countries. Describe this retail network and the partnerships that *BP* has formed in different countries in order to build and maintain this network. What are the benefits and risks?

Hints

1. Media articles about the conflicts within *TNK-BP* can be found, inter alia, at www.ft.com.

2. Focus on the largest countries in which *BP* sells fuel and investigate the franchising agreements and other partnerships. Information can be found, inter alia, at the corporate website.

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