Transnational Management

Text, Cases, and Readings in Cross-Border Management

Third Edition

Christopher A. Bartlett
Sumantra Ghoshal

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THIRD EDITION

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Preface

To many, the attraction of the field of international business management lies in its constant change—the new global strategic imperatives, the new transnational organizational demands. But some old international hands insist that beyond all the hype, the basic tasks of cross-border management remain much as they have always been—understanding one's host country environment, being sensitive to cross-cultural differences, and being able to manage operations separated by the barriers of distance, language, time, and culture.

In a sense, both views are right, and we are reminded of this as we deal with the diverse set of pressures and tensions we must resolve every time we make revisions for a new edition of *Transnational Management*. In this third edition, more than half of the cases and readings are new, a reflection of the vibrancy of the field and a response to those pushing for new materials. But the classic favorites remain, a recognition of the timeless nature of cross-border management issues. Based on the publisher's survey of material usage and fit, as reported by faculty adopters, we have sought to manage this balance between retaining the most widely used cases and articles that continue to work effectively for them, while adding new material that captures the emerging management issues that will keep their courses fresh and their students challenged. The scorecard for this edition reads as follows:

- Seventeen new cases join twelve enduring favorites
- Eight new articles are lined up along ten retained classics
- One new text chapter on cross-border innovation and learning is integrated into our overarching research-based conceptual framework.

Overall, our objective for the third edition of *Transnational Management* remains as it has been from the start: to allow teachers of international management and strategy courses to present leading-edge issues in a rich and holistic fashion that is attuned to the realities of today's complex competitive business environment. Rather than the traditional approach of compartmentalizing the world into neat functional boxes where "international" becomes a weak qualifying adjective, this framework allows the cases and readings to present issues in the way managers receive them—in complex packages in which marketing choices are shaped by development and manufacturing resources, where strategic challenges are linked to operational realities, and where organizational capabilities are bound up with managerial competencies. It is a set of challenges that makes our field unique and exciting, and one that continually stretches us as teachers, researchers, and authors.

Once again, this book is the output of many people's efforts and insights. First, we must thank our faculty colleagues at hundreds of institutions around the world who have adopted this book, and particularly the subset of those who have provided us with feedback and suggestions for its improvement. Specifically, we would like to recognize the 40 faculty who responded to the detailed survey of the structure and content of the second edition. Your comments and proposals became the basis for the restructuring of this volume.

Next, we owe an enormous debt of gratitude to the researchers and authors who contributed new cases and/or articles to this edition. New cases were provided by HBS Professors Linda Hill (Rudi Gassner), Ashish Nanda (Walt Disney), Debora Spar (White Nights, Gerber, and Toys "R" Us) and Michael Yoshino (Star TV). Similarly, new articles incorporate the interesting and important recent research of Ikujiro Nonaka, David Garvin, Tony Gross, Richard Pascal and Anthony Athos, Chan Kim and Renee Mauborgne, Jim Collins and Jerry Porras, and Susan Schneider. To all of them we offer our sincere thanks.

We must also acknowledge the coordination task undertaken by our respective administrative assistants who worked over many months to coordinate the flow of manuscript documents back and forth between London and Boston. To Meg Wozny and Sharon Wilson we give our heartfelt thanks for helping us through the long and arduous revision process. As always, you were there to bail us out and to provide subtle reminders about our frequently missed deadlines. To Jennifer Roche, our new editor at Irwin/McGraw Hill, we thank you for your patience and tolerance through this long process and look forward to a long and productive working relationship. And finally to Craig Beytien, our previous sponsoring editor and now publisher of Irwin/McGraw Hill, we owe the greatest vote of thanks. Always encouraging, but always firmly pushing us to deliver on a manuscript, Craig has been our supportive friend throughout the whole process, and to him we offer our sincere thanks.

Despite the best efforts of all the contributors, however, we must accept responsibility for the shortcomings of the book that remain. Our only hope is that they are outweighed by the value that you find in these pages and the exciting challenges that they represent in the constantly changing field of transnational management.

Christopher A. Bartlett
Sumantra Ghoshal
May 1999

Contents

Chapter 1

Cross-Border Management: Motivations and Mentalities

This book focuses on the management challenges associated with developing strategies and managing the operations of companies whose activities stretch across national boundaries. Clearly, operating in an international rather than a domestic arena presents the manager with many new opportunities. Having worldwide operations not only gives a company access to new markets and specialized resources, it also opens up new sources of information and knowledge to stimulate future product development and broadens the options of strategic moves and countermoves the company might make in competing with its domestic and international rivals. However, with all these new opportunities come the challenges of managing strategy, organization, and operations that are innately more complex, diverse, and uncertain.

In this introductory chapter, we provide a conceptual baseline and a historical backdrop for the more detailed discussions of these management opportunities and challenges that run through the text, cases, and readings in the rest of the book. Our starting point is to focus on the dominant vehicle of internationalization, the multinational corporation (MNC), and briefly review its role and influence in the global economy.[1] Next, we examine the motivations that led such companies to expand abroad and describe how these motivations have evolved over time. We are then ready to review some of the typical attitudes and mentalities that shape the actions of managers in MNCs and suggest how these attitudes and mentalities evolve as their offshore operations progress from the state of initial

[1]Such companies are referred to variously—and often interchangeably—as *multinational, international, and global corporations.* In later chapters, we want to give each of those terms specific different meanings, but will adopt the widely used MNC abbreviation in the broader, more general sense in referring to all companies whose operations extend across national boundaries.

investments to a fully integrated worldwide network of affiliates. In the concluding section of the chapter, we highlight some of the differences between managing an MNC and a purely domestic firm and describe the particular management perspective that influences the structure and content of this book.

THE MNC: DEFINITION, SCOPE, AND INFLUENCE

An economic historian could trace the origins of international business back to the seafaring traders who were central to the ancient civilizations built by the Greeks and Egyptians. Through the centuries, international flow of products continued, and in medieval Venice the merchant traders had developed much of the sophistication of modern-day Japanese trading companies.

An important chapter in this history was written by the great British and Dutch trading companies that flourished in the 17th and 18th centuries, establishing outposts from Hudson's Bay to the East Indies. By the 19th century, the newly emerged capitalists in industrialized Europe began investing in the less-developed areas of the world (including the United States), but particularly within the vast empires held by Britain, France, Holland, and Germany.

Definition

In terms of the working definition we use, few if any of these entities through history could be called true MNCs. Most of the traders would be excluded by our first qualification, which requires that an MNC have *substantial direct investment* in foreign countries, not just an export business. And most of the companies with international operations in the 19th century would be excluded by our second criterion, which requires that they be engaged in the *active management* of these offshore assets rather than simply holding them in a passive financial portfolio.

Thus, while companies that source their raw materials offshore, license their technologies abroad, export their products into foreign markets, or even hold minority equity positions in overseas ventures without any management involvement may regard themselves as "international," by our definition they are not true MNCs unless they have substantial direct investment in foreign countries *and* actively manage those operations and regard those operations as integral parts of the company both strategically and organizationally.

Scope

Under our definition, the MNC is a very recent phenomenon, dating back to less than a century. In fact, a vast majority have been developed only in the post–World War II years. However, their motivations for international expansion and the nature of their offshore activities have evolved significantly over this relatively short period, and we explore some of these changes later in this chapter.

Among the more important recent trends have been the emergence of service MNCs and a shift from traditional ownership patterns between the parent company and its worldwide operations to a new and varied set of financial, legal, and contractual relationships with different foreign affiliates. Our definition of MNCs can incorporate these new developments, as long as we recognize that foreign "investment" need not be restricted to production facilities alone and that "active management" does not require direct control but only substantive influence over the activities of foreign units that can often be exercised without full or even majority ownership.

It is interesting, in this context, to observe how the United Nations has changed its definition of the MNC over the last two decades.[2] In 1973, it defined such an enterprise as one "which controls assets, factories, mines, sales offices, and the like in two or more countries." By 1984, it had changed the definition to

> an enterprise (a) comprising entities in two or more countries, regardless of the legal form and fields of activity of those entities, (b) which operates under a system of decision making permitting coherent policies and a common strategy through one or more decision-making centers, (c) in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise a significant influence over the activities of the others, and, in particular, to share knowledge, resources, and responsibilities with others.

In essence, the changing definition highlights the importance of strategic and organizational integration and, thereby, *management integration* of operations located in different countries as the key differentiating characteristic of an MNC. The resources committed to those units can just as well take the form of skilled people or research equipment as plant and machinery or computer hardware. What really differentiates the MNC is that it creates an internal organization to carry out key cross-border tasks and transactions internally rather than depending on trade through the open markets. With this understanding, our definition of MNCs includes American Express, Andersen Consulting, and Fuji Bank just as well as IBM, Unilever, and Hitachi.

MNC Influence in the Global Economy

Most frequent international business travelers have had an experience like the following. She arrives on her British Airways flight, rents a Toyota at Hertz, and drives to the downtown Hilton hotel. In her room, she flips on the Sony TV, and absent-mindedly gazes out at the neon signs flashing "Coca-Cola," "Canon," and "BMW." The latest episode of "Friends" is flickering on the screen when room service

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[2]The generic term for companies operating across national borders in most UN studies is the *transnational corporation* (TNC). Because we will use that term very specifically, we will continue to define the general form of organizations with international operations as MNCs.

delivers dinner along with the bottle of Perrier she ordered. All of a sudden, a feeling of disorientation engulfs her. Is she in Sydney, Singapore, Stockholm, or Seattle? Her surroundings and points of reference over the past few hours have provided few clues.

Such experiences, more than any data, provide the best indication of the enormous influence of MNCs in the global economy. As the cases and articles in this book will show, few sectors of the economy and few firms—not even those that are purely domestic in their operations—are free from this pervasive influence. Collectively, MNCs account for over 40 percent of the world's manufacturing output and almost a quarter of world trade. About 85 percent of the world's automobiles, 70 percent of computers, 35 percent of toothpaste, and 65 percent of soft drinks are produced and marketed by MNCs.

While not all MNCs are large, most large companies in the world are MNCs. In fact, about 450 companies with annual revenues in excess of $1 billion account for over 80 percent of the total investment made by all companies outside their home countries. A different perspective on their size and potential impact is provided by Table 1–1, which compares the annual gross national products (GNPs) of selected countries with the annual revenues of several large MNCs. One must be careful, however, in basing conclusions on this table. A country's GNP is not directly comparable with a company's revenues. Besides, only a handful of companies are as large as those shown in the table and, increasingly, small companies are becoming important players internationally. Nevertheless, most of the world's attention tends to focus on these large MNCs, which have the greatest influence on the global economy, employ a high percentage of business graduates, and pose the most complex strategic and organizational challenges for their managers. For the same reasons, they will provide the focus for much of our attention in this book.

TABLE 1–1 Comparison of Country GNPs and Company Revenues: 1996

Company	*Annual Revenue ($ billions)*	*Country*	*Annual GNP ($ billions)*
General Motors	168	Denmark	168
Ford	146	Hong Kong	153
Mitsui	144	Norway	151
Mitsubishi	140	South Africa	132
Itochu	135	Poland	124
Royal Dutch Shell	128	Greece	120
Marubeni	124	Finland	119
Exxon	119	Portugal	100
Sumitomo	119	Singapore	93
Toyota	108	Israel	90

Source: World Development Report published by the United Nations and *Fortune*'s list of the 500 largest companies in the world.

THE MOTIVATIONS: PUSHES AND PULLS TO INTERNATIONALIZE

What motivates companies to expand their operations internationally? While occasionally the motives may be entirely idiosyncratic, such as the desire of the CEO to spend time in Mexico or in Europe, an extensive body of research suggests some more-systematic patterns.

Traditional Motivations

Among the earliest motivations that drove companies to invest abroad was the need to *secure key supplies,* especially minerals, energy, and scarce raw material resources. Aluminum producers needed to ensure their supply of bauxite, tire companies went abroad to develop rubber plantations, and oil companies wanted to open up new fields in Canada, the Middle East, and Venezuela. By the early part of this century, Standard Oil, Alcoa, Goodyear, Anaconda Copper, and International Nickel were among the largest of the emerging MNCs.

Another strong trigger of internationalization could be described as the *market-seeking* behavior. This motivation was particularly strong in companies that had some intrinsic advantage, typically related to their technology or their brand recognition, that gave them some competitive advantage in offshore markets. Although their initial attitudes were often opportunistic, many companies eventually realized that these additional sales allowed them to exploit economies of scale and scope, thereby providing a source of competitive advantage over their domestic rivals. This was a particularly strong motive for some of the European multinationals whose small home markets were insufficient to support the volume-intensive manufacturing processes that were sweeping through industries from food and tobacco to chemicals and automobiles. Companies like Nestlé, Bayer, and Ford expanded internationally primarily in search of new markets.

Another traditional and important trigger of internationalization was the desire to *access low-cost factors* of production. Particularly as tariff barriers declined in the 1960s, many U.S. and European companies for whom labor represented a major cost found that their products were at a competitive disadvantage compared to imports. In response, a number of companies in clothing, electronics, household appliances, watchmaking, and other such industries established offshore sourcing locations for producing components or even complete product lines. Soon it became clear that labor was not the only productive factor that could be sourced more economically overseas. For example, the availability of lower-cost capital (perhaps through a government investment subsidy) also became a strong force for internationalization.

These three motives (or two, if we ignore the historical differences and combine securing supplies and accessing low-cost factors into a single resource-seeking motive) were the main traditional driving forces behind the overseas expansion of a vast majority of MNCs. The ways in which these motives interacted to push companies—particularly those from the United States—to become MNCs are captured in the well-known product cycle theory developed by Professor Raymond Vernon.[3]

This theory suggests that the starting point for the internationalization process is typically an innovation that a company creates in its home country. Because large, economically advanced, and technologically sophisticated countries like the United States historically provided the most incentives and the greatest opportunities for developing new products or ideas, most of these innovations tend to be created by companies located in these countries.

Consider the case of a typical U.S. company that has developed an innovative new product. In the first phase of exploiting the development, the company will build production facilities in its home market not only because this is where its main customer base is located, but also because of the need to maintain close linkages between research and production in this phase of the development cycle. In this early stage, some demand may also be created in other developed countries—in European countries, for example—where consumer needs and market development are similar to the United States. These requirements normally would be met out of home production, thereby generating exports for the United States.

As the product matures and production processes become standardized, the company enters a new stage. By this time, demand in the European countries may have become quite sizable and export sales, from being a marginal side benefit, are now an important part of the revenues from the new business. Furthermore, competitors will probably begin to see the growing demand for the new product as a potential opportunity to establish themselves in markets served by exports. To prevent or counteract such competition and also to meet the foreign demand more effectively, the innovating company typically sets up production facilities in the importing countries, thereby making the transition from being an exporter to becoming a true MNC.

Finally, in the third stage, the product becomes highly standardized and many competitors enter the business. Competition now focuses on price and, therefore, on cost. This activates the resource-seeking motive, and the company moves production to low-wage developing countries, both to meet local demand that has by now sprung up in these countries, and also to meet the demands of its customers in the developed markets at a lower cost. In this final phase, the developing countries may become net exporters of the product while the developed countries become net importers.

The record of international expansion of companies in the post–World War II era is quite consistent with the pattern suggested by the product cycle theory. For example, between 1950 and 1980, U.S. firms' direct foreign investment (DFI) increased from $11.8 billion to $200 billion. In the 1950s, much of this investment focused on the neighboring countries in Latin America and Canada. By the early 1960s, attention had shifted to Europe and the EEC's share of U.S. firms' DFI

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[3]Raymond Vernon, "International Investment and International Trade in the Product Cycle," *Quarterly Journal of Economics,* May 1966, pp. 190–207.

increased from 16 percent in 1957 to 32 percent by 1966. Finally, in the 1970s, attention shifted to developing countries, whose share of U.S. firms' DFI grew from 18 percent in 1974 to 25 percent in 1980.

Although the product cycle theory provided a useful way to describe much of the internationalization of the postwar decades, by the 1980s its explanatory power was beginning to wane as Professor Vernon was quick to point out. As the international business environment became increasingly complex and sophisticated, companies developed a much richer rationale for their worldwide operations.

Emerging Motivations

An examination of the decisions that triggered early international expansion of most MNCs reveals that few did so with any clearly defined global objectives or well-developed international strategy. Internationalization was typically a gradual and an incremental process, most often linked to the company's basic home market strategic objectives. Some were trying to secure critical raw material supplies, for example, while others were seeking new markets or lower-cost sources in order to protect or improve competitive position at home.

However, once they had established international sales and production operations, the perceptions and strategic motivations of most of these companies gradually changed. Initially, the typical attitude was that the foreign operations were strategic and organizational appendages to the domestic business, and should be managed opportunistically. Gradually, however, as managers recognized some of the important advantages of operating internationally, they began to think about their strategy in a more integrated worldwide sense. In this process, the forces that originally triggered their expansion overseas often became secondary to a new set of motivations that underlay their emerging global strategies.

In many cases, these new motivations were driven by a set of economic, technological, and social developments that made internationalization essential for a company to survive in particular businesses. For example, successive rounds of technological change brought about by the adoption of integrated circuits, autoinsertion machines, printed circuit boards, and computerized assembly and testing raised the efficient scale for production of color television sets from about half a million sets a year to over 3 million sets. As a result, companies that had historically focused only on their domestic markets had to either become international or go out of business since few countries were large enough to support production at such scale by individual companies.

Escalating R&D costs and shortening product life cycles were also internationalizing forces. For example, the advent of digital technology raised the costs of developing a public telephone switching system to about a billion dollars. At the same time, because of accelerating technological developments, telecommunications companies had increasingly shorter time periods to sell a particular product before it was made obsolete by new technology. The combination of these two factors made it impossible for such companies to remain in business unless they had access to worldwide markets to amortize past R&D expenses and fund ongoing research.

In essence, those forces of *increasing scale economies, ballooning R&D investments,* and *shortening product life cycles* transformed many industries into global rather than national structures and made worldwide scope of activities not a matter of choice but indeed an essential prerequisite for companies to survive in those businesses. In the next chapter, we discuss these globalizing forces and examine their implications in much greater detail.

Although it was less frequently the original motivating trigger that induced companies to invest abroad, an important secondary effect that often became a critical factor in a company's international strategy was its global *scanning and learning* capability.[4] A company drawn offshore to secure supplies of raw materials was more likely to become aware of alternative low-cost production sources around the globe; a company tempted abroad by market opportunities was often exposed to new technologies or market needs that stimulated innovative product development. The very nature of an MNC's worldwide presence gave it a huge informational advantage that could result in locating more-efficient sources or more-advanced or appropriate product and process technologies. Thus, a company whose international strategy was triggered by a technological or marketing advantage could enhance that advantage through the scanning and learning potential inherent in its worldwide network of operations.

Another benefit that soon became evident was that being a multinational rather than a national company brought important advantages of *competitive positioning.* Certainly, the most controversial of the many global competitive strategic actions taken by MNCs in recent years have been those based on cross-subsidization of markets. For example, a Korean TV producer could challenge a national company in the United States by subsidizing its U.S. losses with funds from its profitable Asian or South American operations. If the U.S. company depended entirely on its home market, its competitive response could only be to defend its position—typically by seeking government intervention or by matching or offsetting the competitive price reductions. Recognition of these competitive implications of multicountry operations led some companies to change the criteria for their international investment decisions so as to reflect not only market attractiveness or factor cost-efficiency choices, but also to reflect the leverage such investments provided over competitors.[5]

Although for purposes of analysis—and also to reflect some sense of historical development—the motives behind the expansion of MNCs have been reduced to a few distinct categories, it should be clear that companies were rarely driven by

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[4]This motivation was highlighted by Raymond Vernon in "Gone Are the Cash Cows of Yesteryear," *Harvard Business Review,* November–December 1980, pp. 150–55.

[5]These competitive aspects of global operations, the focus of our discussions in Chapter 3, have been highlighted in a number of articles by authors such as Michael Porter, Bruce Kogut, C. K. Prahalad, Gary Hamel, John Stopford, and George Yip; see readings and references in Chapter 3.