

Nitin Nohria
Sumantra Ghoshal

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— The —
DIFFERENTIATED
NETWORK

**Organizing Multinational
Corporations
for Value Creation**

The Differentiated Network

Organizing Multinational Corporations
for Value Creation



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The Differentiated Network

Nitin Nohria
Sumantra Ghoshal

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*To Monica and Susmita
with love and appreciation*

Preface

This book represents the synthesis of a stream of research that began more than a decade ago when we were both at the Massachusetts Institute of Technology. It is based on a series of papers that we have written over this period, some together, others in collaboration with graduate students and colleagues who became interested in our research and joined us in advancing it further.

We decided to write this book because we felt that even though we had published many of the ideas in various outlets, the sum of these parts did not adequately capture all we had learned through our research. A major theme in this book is that to be truly effective, multinational corporations should be differentiated and integrated. Similarly, this book represents an attempt to integrate what might otherwise have remained differentiated parts.

The primary idea we wish to advance here is that the modern MNC must be organized as a differentiated network to tap the full value-creation potential of its globally distributed capabilities. This basic idea is not new. Indeed, it has been elaborated in some detail by Chris Bartlett and Sumantra Ghoshal in *Managing Across Borders: The Transnational Solution* (1989), a book that is the intellectual forebear of this one. What is new in this book is a more systematic examination of this core idea—especially an effort to ground the concept of a differentiated network more firmly in organization theory and to test its validity more rigorously using large-sample data.

Our aspirations in writing this book are twofold. First, we continue to believe that despite their increasing importance in the global economy, MNCs remain neglected in organization theory.

This neglect, we believe, stems in part from the practical difficulties of studying these complex organizations. We hope that the concepts and the pragmatic empirical strategies advanced in this book will stimulate more research on MNCs.

Second, we wish to revive interest in the topics of organization structure and design. The internal structures and processes of complex organizations was a subject of intense study in the 1970s, the heyday of contingency theory. However, since then, these topics have taken a backseat to an interest in the organization's environment. Indeed, in most of the currently popular strands of organization theory, such as population ecology, institutional theory, network analysis, and organizational economics, the internal organization of firms is almost completely neglected. Though much has been learned from these new perspectives, we feel that it is time to think about organization design again, especially because the concepts advanced in the 1970s do not always provide a good guide for designing organizations moving forward into the new millennium.

As these aspirations indicate, this book is written primarily for our academic colleagues. Yet we have tried to write in plain English. We hope that practitioners will thus be able to read and benefit from this book. To enhance their interest in doing so, we have explicitly spelled out the practical implications of our findings throughout the book.

This book's intellectual genesis lies in the work of Chris Bartlett. We owe him a great debt for having introduced us to the fascinating world of MNCs and for having been a mentor, friend, and research partner throughout the years. This book could never have been written without his contributions.

We also wish to thank Luis Almeida-Costa, Ranjay Gulati, Monica Higgins, Harry Korine, Peter Moran, and Gabriel Szulanski, our coauthors on some of the papers that we draw on in this book. Don Lessard, Michael Scott-Morton, and Eleanor Westney, our teachers at MIT, have had an intellectual influence on us that is evident throughout this book.

As we have all experienced, the final 20 percent of the work involved in writing a book seems to take 80 percent of the time. Ramin Toloui, our research associate, was a driving force for this project during this final stage. We are also grateful to Peter Amirault, Vanita Datta, Diana Line, and Misiek Piskorski for burning the midnight oil to help complete this book. Cedric Crocker and David Horne, our editors at Jossey-Bass, waited patiently and showed remarkably good cheer as we struggled to meet our deadlines. Their encouragement was instrumental in enabling us to get this book done.

We would also like to thank the Division of Research at the Harvard Business School and Booz, Allen, and Hamilton, the sponsors of the Strategic Leadership Research Program at the London Business School, for their generous support.

Finally, we reserve our last acknowledgment for the two people who have sacrificed the most for the cause. In recognition of the numerous occasions when we turned over to them at home work that we should have done ourselves, we dedicate this book to Monica Chandra and Susmita Ghoshal, our wives. We hope that they will deem the result worthy of all they have given up for it.

London
January 1997

Nitin Nohria
Sumantra Ghoshal

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Chapter One

The Differentiated Network

It was about thirty years ago that Vernon (1966) proposed the product cycle theory that identified the ability to innovate as the *raison d'être* for multinational corporations. Over the past three decades, many new theories have been proposed to explain why MNCs exist, but innovation has continued to occupy center stage in these explanations (see Calvet, 1981). The multinational's facility to invest and manage its affairs in many different countries, it is argued, allows it to secure the benefits of innovations in multiple locations through its own internal organization more effectively than market-mediated mechanisms (Buckley and Casson, 1976; Rugman, 1981).

As this characterization suggests, the focus of traditional theories of innovation in the MNC has been on knowledge appropriation. The multinational is an organizational form that internalizes knowledge flows that would otherwise have to take place through market transactions among its diverse set of subsidiary organizations. Because the price mechanism fails to value knowledge properly in the marketplace, thus inhibiting socially beneficial transactions, the multinational creates value by internalizing knowledge flows. This account of the existence of the MNC is simply a version of the standard microeconomic transaction cost theory of the firm. It is in essence a *negative* theory of the firm: the reason for the existence of the firm is described in terms of its facility to avoid a stifling market failure.

Increasingly, however, the MNC's ability merely to enable the flow of knowledge from its headquarters to its national subsidiary units no longer represents a sufficient competitive advantage. The