

**United Nations Library on Transnational
Corporations**

Volume 6

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Note

The Transnational Corporations and Management Division (formerly the United Nations Centre on Transnational Corporations) of the United Nations Department of Economic and Social Development serves as the focal point within the United Nations Secretariat for all matters related to transnational corporations and acts as secretariat to the Commission on Transnational Corporations, an intergovernmental subsidiary body of the United Nations Economic and Social Council. The objectives of the work programme are to further the understanding of the nature of transnational corporations and of their economic, legal, social and political effects on home and host countries and in international relations, particularly between developed and developing countries; to secure effective international arrangements aimed at enhancing the contribution of transnational corporations to national development goals and world economic growth; and to strengthen the negotiating capacity of host countries, in particular the developing countries, in their dealings with transnational corporations.

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Preface

The importance of transnational corporations and the globalization of production are now well recognized. Transnational corporations have become central actors of the world economy and, in linking foreign direct investment, trade, technology and finance, they are a driving force of economic growth. Their impact on the economic and social welfare of developed and developing countries is both widespread and critical.

It is one of the functions of the Transnational Corporations and Management Division (formerly the United Nations Centre on Transnational Corporations) – the focal point in the United Nations for all issues relating to transnational corporations – to undertake and promote research on transnational corporations to contribute to a better understanding of those firms and their impact. Over the past thirty years, research on this phenomenon has mushroomed, and hundreds of books and reports, as well as thousands of papers, have been published. It is the principal purpose of this twenty-volume *United Nations Library of Transnational Corporations* to distil, summarize and comment on some of the more influential of those writings on the role of transnational corporations in the world economy. In particular, the contributions in the *United Nations Library* deal with four main issues; namely, the determinants of the global activities of transnational corporations, their organizational structures and strategies, their interactions with the economies and legal systems of the countries in which they operate and the policies that governments pursue towards those corporations. The twenty volumes are intended to cover a wide range of topics that embrace economic, organizational and legal issues.

To accomplish that task, the Centre assembled a distinguished group of editors, who were commissioned to select the seminal contributions to their subject areas published over the past twenty to thirty years. They were also asked to prepare comprehensive bibliographies of writings on their subjects for inclusion in the volumes, and state-of-the-art introductions that

summarize the development of their subjects, review the most important current issues and speculate about future work. We hope that the result in each case is a volume that provides a succinct, yet comprehensive, overview of the subject to which it is devoted.

Since the early 1960s, organizational scholars have sought to analyse the consequences of the internationalization of business activity for the organizational structure and the geographical locus of decision-making of firms. Moreover, as firms have increased their degree of transnationalization, analysts have observed their need to adapt their organizational structures and the locus of decision-making. From some of the pioneering work of Alfred Chandler and Howard Perlmutter, which viewed companies as hierarchies with a series of intra-firm uni-dimensional relationships, to today's emphasis on heterarchies and multidimensional networks, scholars have sought both to explain the way in which transnational corporations organize their cross-border activities and to suggest ways in which they might better organize those activities.

The reader will observe that many of the contributions chosen by Gunnar Hedlund, Professor in the Institute of International Business at the Stockholm School of Economics, for the present volume are of very recent origin. The 1980s have seen a burgeoning of research into all aspects of the organizational behaviour of transnational corporations, as both scholars and practitioners have increasingly found that the way in which global firms manage their competitive advantages is an important competitive advantage in itself. Moreover, such management differs according to both the nationality of firms and the kind, extent and location of investment undertaken. In particular, Hedlund and several contributors show that differences between the internal governance of Japanese and other transnational corporations go a long way towards explaining both the structure of the foreign operations of the two groups of companies and their competitive strengths and weaknesses in global markets.

Since, in the 1990s, both intra- and inter-firm organizational relationships are likely to become a more important discriminating feature explaining both the impact and consequences of transnational corporation activity, this is indeed a timely volume, which contains contributions of highly practical significance to both enterprises and governments.

New York, July 1992

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Introduction: Organization and Management of Transnational Corporations in Practice and Research

Gunnar Hedlund

The aim of the present volume is to provide a comprehensive selection of critical analyses, published over the past two decades, on the organization and management of the transnational corporation (TNC). Those companies develop and control vast resources and capabilities, and the nature and quality of their management considerably affect global welfare. The special problems presented in an international context require approaches, solutions and skills not readily available in its documented experience of national management. Therefore, practitioners as well as researchers need to become familiar with these issues in their real context, rather than work from abstract and simplified principles, or from parochial views reflecting single national environments. The same goes for public policymakers, who need to understand what really goes on in a TNC. The sophistication of contemporary global intra-firm coordination poses challenges for national governments and for formal methods of international collaboration. It may also suggest new ways of more effectively serving pressing needs for cooperation between countries.

The experiences of first world TNCs should be of particular interest to corporations from developing countries. Companies internationalizing from home bases in these countries should benefit from knowing how more experienced TNCs have developed, what problems they have encountered and what solutions have been tried. Also, governments, other public bodies and trade unions in developing countries often negotiate with TNCs. A thorough knowledge of how these companies are organized and managed should improve the quality of interaction and help overcome the information advantages often accruing to TNCs.

The TNC is important in still another, more indirect, way. It is among the most complex of human institutions and, thus, presents formidable problems of management. Since a TNC generally works in competitive markets (albeit often dominated by oligopolies), there is a selection process

constantly testing methods and approaches. This distinguishes the TNC from many other complex institutions, which are granted a more tranquil, perhaps monopolized, constitutional setting. Learning between firms is a further characteristic of the TNC, speeding up the evolution and diffusion of the latest managerial and organizational practices.

For those reasons, the TNC constitutes a kind of experimental arena, on which extremes of complexity, interdependence and change are confronted. Both practical and theoretical ideas of wider relevance are thereby tested and developed, perhaps before they are even considered in more restricted circumstances. The TNC, and research on it, may thus serve as an avant-garde for management and aspects of management and organization theory, in a wide sense of the concepts. This applies to strategic and public-policy related issues, as well as to structural and managerial ones. The focus in this volume is on the *how* of international management, whereas a related volume, edited by Donald Lecraw and Allen Morrison on the strategy of the TNC, is more directed to the *what*. Still other volumes, and particularly that edited by John Dunning, concentrate on the *why*, explaining the very existence of the TNC and the nature and magnitude of its operations.

From Country Subsidiaries to Global Integration

A brief historical reflection may serve as a good starting-point for the understanding of the evolving models of TNC organization. Most of the early TNCs, from the end of the last century and onwards for half a century or so, were, in some sense, appendices of national firms. Successful developments of unique products were first exploited on the home market. Only later, and in a cautious and gradual fashion, were foreign markets and resource bases approached. (The literature on the international product cycle initiated by R. Vernon, 1966, documents this process, as do European contributions such as J. Johanson and J. Vahlne, 1977; R. Luostarinen, 1979; and G. Newbould, P. Buckley and J. Thurwell, 1978.) For resource-based firms, investment abroad was often necessary to secure essential minerals and raw materials. In either case, managing the foreign unit was a rather straightforward affair. The headquarters perspective dominated both in terms of formal power and in terms of competence, resources and strategic outlook. H. Perlmutter's (1965) "ethnocentric" firm is an archetype of this early form of TNC.

A second, and subsequently more common, type of TNC resembles H. Perlmutter's "polycentric" company, or C. Bartlett's (1986) "decentralized federation". Sometimes under the influence of trade barriers, many TNCs built strong national entities, with their own manufacturing and, in some cases, research and development resources. They were largely self-

sufficient in terms of managerial manpower and finance. Political and economic factors restricted flows between countries. In particular, the large European TNCs were strongly affected by that development. They organized into groups with very wide control spans from the point of view of headquarters. National subsidiaries became important and powerful institutions in their own setting, often resisting efforts of parent company encroachment.

The reduction of trade barriers, corporate growth, international dissemination of technology and a host of other factors gradually undermined this decentralized model in most industries. TNCs exploited scale advantages by relocating production, faced competitors with a global, rather than "multidomestic" (Porter, 1986) rationality, and started to scan for acquisition candidates also in order to assimilate new technology. In a number of areas, TNCs found that they had to adopt a *geocentric* view. (Or, in Bartlett's (1986) words, they managed a "coordinated network".) An organization theorist J. Thompson (1967) characterizes that development as one from sequential to reciprocal interdependence. Given that the latter requires the most sophisticated and costly coordination mechanisms, and given that the units reciprocally interdependent on each other are themselves large, complex organizations, the management challenge is, to say the least, a substantial one.

Systematic research on the TNC mirrors the evolution of corporate practice and of the global environment. There is a progression of different foci, starting with the formal organization structure and moving towards increasingly subtle combinations of control instruments, and to analyses of change processes over time. Simple and reductionist models break down when confronted with the complexity of the TNC.

What follows below is an effort to summarize some critical strands of academic research and place the pieces selected for this volume in a wider context.¹ The object is to focus on some core *types* of analysis and to provide the reader with a broad set of references, which will allow deeper and more specialized study as a next step.² The selection is confined to contributions published in the English language. Further limitations are that the very early stages of international business in general, as well as the first stages in individual companies' development, are not treated. (For the former, see, for example, M. Wilkins, 1974, 1977.) Finally, discussion of more narrow functional areas, such as accounting, finance, marketing, human resources, etc., have not been included.

The Evolution of Organizational Structure

The basic alternatives for the organizational structure of a TNC, and their main strengths and weaknesses, were identified as soon as these questions

started to be debated in academic journals and business magazines. (E. Barlow, 1953; G. Clee and A. di Scipio, 1959; G. Clee and W. Sachtjen, 1964; L. Fouraker and J. Stopford, 1968; D. Rutenberg, 1970; H. Schollhammer, 1971; and many others.) Dividing the company along the dimensions of function, product or geography was the crucial point of discussion. The debate was given analytical rigour by adopting and further developing the framework of Alfred Chandler's (1962) pioneering study. Chandler provided an historical analysis of growth patterns and administrative consequences of growth in large corporations from the United States. A number of national studies followed that charted the evolution of firms from the United Kingdom (Channon, 1973), Germany and France (Dyas and Thanheiser, 1976) and Italy (Pavan, 1972).

Other researchers focused more explicitly on the international dimension. A large project at the Harvard Business School led to seminal studies by J. Stopford and L. Wells (1972), L. Franko (1976) and M. Yoshino (1976) on, respectively, large TNCs from the United States, continental Europe (excluding the United Kingdom) and Japan. Corporate strategy, usually conceived of in terms of degrees of product diversification and geographic dispersion of sales, was found to be related, with a time lag, to corporate structure, where the main distinction was between various area structures and a split by product.

Summaries of those three studies are contained in the first three selections for this volume. On the whole, the results fitted a strategy-structure framework. Most TNCs from the United States exhibited a clear development from single, autonomous (reporting straight to headquarters) subsidiaries, over an international division, to global product (mostly) divisions. The European case indicated a greater historical reliance on a continued decentralized, parent-affiliate structure and on informal, personalized control. In Japan, the evolution had not passed the stage of the international division, and the unique Japanese management culture was shown to influence, and hypothesized to be an obstacle for, the global organization of the firms.

Later studies added detail and, by and large, supported the earlier findings. Many of them moved the analysis far beyond formal organizational structure. For the United States, studies by W. Egelhoff (1982) and J. Daniels, R. Pitts and M. Tretter (1984, 1985) are noteworthy. T. Kagono (1981) and N. Kobayashi (1980, 1986) added to the knowledge about Japanese firms, by charting changes in management systems and (Kagono) applying an information-processing perspective, analogous to Egelhoff's (1982) treatment, on the issue. German TNCs were discussed by M. Welge (1981). D. Horvath (1975), G. Hedlund (1980, 1981, 1984), L. Leksell (1981) and G. Hedlund and P. Åman (1984) provided detailed descriptions of Swedish companies.

The earlier studies tended to work with rather crude organizational cate-

gories, like functional and divisional structure, and were later criticized by scholars for this (see, for example, R. Caves, 1980). The critique concerned the breadth and ambiguity of categories ("division" means very different things in different companies) and the relevance of the formal structure in understanding how TNCs are actually controlled. However, careful reading often shows a keen awareness of nuances. For example, the early important contribution by M. Brooke and H. Remmers (1970) contains in-depth discussions of process issues and swings in degree of centralization over time. The explicit focus on subtler aspects of management increases in the late 1970s and early 1980s. W. Davidson and P. Haspeslagh's (1982) piece, reproduced in this volume, is an example of a reassessment of a basic organizational trend. The global product division is shown to be less than the panacea it was made out to be in much of the more popular management literature. In similar fashion, the previously mentioned studies of German and Swedish TNCs stressed the importance of the fine detail of TNC organization. Structures "in between" pure forms were found to prevail (Hedlund, 1984). Also, the conception of strategy was successively enriched. Whereas the earliest studies focused on dependence on foreign sales and degree of product diversity, later researchers included analyses of the association between organizational structure and strategic variables such as vertical integration and research and development intensity (Daniels, Pitts and Tretter, 1985).

Studies directly comparing TNCs from different countries contributed to finer distinctions. Egelhoff (1984), selected for this volume, is one example, showing that control philosophies in the United States and Europe differ significantly. United States companies rely to a greater extent on formal mechanisms of control, whereas in Europe informal, personalized methods are more important. The findings are almost identical to Franko's earlier ones, but the theoretical frame is different, building on W. Ouchi's (1977) conceptual work. The emergence of Japanese and German TNCs inspired many researchers, for example A. Negandhi and M. Welge (1984).

Other comparative studies focused on degree of centralization and formalization of decision-making (Picard, 1980; Garnier, 1982; Goehle, 1980; van den Bulcke, 1984; van den Bulcke and Halsberghe, 1984; Hedlund, 1981; Gates and Egelhoff, 1986; Martinez and Ricks, 1989; and many others). They confirmed a diversity of management styles between countries, and also analysed some other predictors of centralization, such as intra-company resource flows, age and size of the firm, product diversity, nature of the subsidiary, etc. It is difficult to summarize that literature, since results differ on many points. However, most contributions agree that interdependence between headquarters and subsidiaries, for example through product flows, tends to reduce subsidiary autonomy. Also, differences between functional areas are documented. Finance and

research and development tend to be more centralized, whereas marketing and personnel are more decentralized to the subsidiary. However, the most recent studies question, although mostly implicitly, the usefulness of the centralization variable. In an internally richly interconnected TNC system, the coordination tasks are too complex to be resolved by simply deciding on the distribution of influence between headquarters and subsidiary.

Control and Coordination Instruments

Research since the late 1970s has increasingly taken a clinical bent, in order to capture the detail which was clearly crucial to understanding the modern TNC. A series of studies by C.K. Prahalad and Y. Doz significantly sharpened the picture of how TNCs were organized and managed in practice. The selection for this volume is a synthesis of parts of their work, and an interpretation of their findings in a dynamic perspective of process change. It suggests a position in between a purely selectionist one (*à la* population ecology) and an extremely adaptationist one (as articulated in much of the managerially-oriented literature). The piece is also interesting as it exemplifies an increasing and wider interest in theoretical issues of a more general character among TNC researchers.

Bartlett (1982), in an important study, de-dramatized the importance of wholesale structural change as an appropriate management method. Also, the largely clinically-oriented Swedish studies (Hedlund, 1978, 1980 and 1984; Leksell, 1981) gave organizational structure a limited, albeit still interesting, role. Instead, normative control through shared norms and outlook, internal promotion and personnel transfers were emphasized. Similar conclusions were drawn by Kagono (1981) for Japanese firms.

J.I. Martinez and J. Jarillo (1989, and in this volume) provide a good summary of the trend in research. Here it suffices to note the growing emphasis on informal control mechanisms and on human resource management aspects in particular. A. Edström and J. Galbraith's (1977) piece is reproduced in this volume since it is the first widely circulated, research-based analysis of the uses of personnel transfer in TNCs. Their analysis foreshadows much of the later discussion. A. Jaeger (1983) and B. Baliga and A. Jaeger (1984) contribute to the tradition of characterizing different control styles and to the emergence of "organic" views, by suggesting cultural control as a fundamental control philosophy.

The importance of cultural and historical variables for the choice of organizational form and management style was already apparent in Franko's (1976) analysis. The interpretation of these differences was rather eclectic, stressing a number of economic, historical, institutional, political and cultural factors. Some researchers tried explicitly to isolate and describe the cultural aspects. Apart, of course, from more purely anthro-

pological and sociological analyses, the literature on “comparative management” was an early reflection of such interests. However, it mostly did not focus specifically on the management of the entire TNC.

G. Hofstede (1985) and A. Laurent (1981) have been selected for this volume, since they represent some of the most ambitious research, and since they both deal directly, in part at least, with problems pertaining to the TNC. By and large, the observed differences in organizational form are shown to be related to conceptions of management and to work-related values. For example, the insistence on “uncertainty avoidance” characteristic of Latin cultures according to Hofstede (1980) is mirrored by suspicions concerning the viability of matrix organization in these countries (Laurent, 1981). Laurent’s research also seems to indicate that national differences in this respect are *not* evened out for individuals working in a TNC. A scenario of globalized, culturally neutered national managers of TNCs is not, thus, supported by the best and most recent research. If anything and on balance, evidence from that scholarly tradition also suggests more pluralism and relativity than universalism.

Perspectives by Economists and Economic Historians

The research reviewed so far comes mainly from a tradition of business policy and organizational theory. Often, it has drawn selectively on concepts and theories from economics and economic history. It is, therefore, appropriate in this volume to include certain representative discussions by economists.

Chandler’s work has already been mentioned as inspiring a whole set of studies in the strategy–structure paradigm. That work is also important in a more macro-institutional context. In this volume (reprinted from Chandler, 1982), he discusses the nature of industrial groups in a number of countries. The focus is rather to make cross-country comparisons than on analysing the institution (the TNC) spanning over countries. However, the national history is of great importance for the understanding of later international developments. For example, it seems clear that the emergence of the multidivisional firm in the United States was driven by internal factors, and that the global product division is a kind of extension of the national division. The analysis is important also in highlighting the role of the quest for monopoly and market dominance by large corporations. Global organization does indeed become an effect of global strategy. The interpretation of “strategy” in that view is, however, significantly different from the one adopted in the business-school type of literature. In the latter, Chandler’s proposed alternative to M-form administrative rationalization – legal contractual cooperation, such as in cartels – is not really discussed at all as a determinant of organizational form. (Franko’s, 1976, analysis of interwar