Managing across Borders:
New Strategic Requirements

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THE DEMANDS OF MANAGING in an international operating environment changed considerably over the past decade. In an increasing number of industries, the benefits of exploiting global economies of scale and scope enhanced the need for integration and coordination of activities. At the same time, volatile exchange rates, industrial policies of host governments, resistance of consumers to standardized global products, and the changing economics of flexible manufacturing technologies increased the value of more nationally responsive differentiated approaches. And with the emergence of competitive battles among a few large firms with comparable resources and skills in global-scale efficiency and nationally responsive strategies, the ability to learn—to transfer knowledge and expertise from one part of the organization to others worldwide—became more important in building durable competitive advantage. Managers of multinational companies (MNCs) are now faced with the task of optimizing efficiency, responsiveness, and learning simultaneously in their worldwide operations—which suggests new strategic and organizational challenges.

This is the first of two articles that explore this new situation; they are based on a research project that involved extensive discussions with more than 250 managers in nine of the world's largest multinational companies. In this article we will describe the strategic challenges these companies faced because of increasing complexity of environmental demands, and the ways in which they tried to respond to those challenges. Our analysis suggests that, for most MNCs, limited organizational capability (rather than lack of analysis or insight) represents the most critical constraint in responding to new strategic demands. In the follow-up article, we will describe how companies are trying to overcome this constraint by building a very different kind of multinational organization, one that can cope with the increasing complexity of the international environment.

New Challenges: Mixed Responses

The international operations of all the companies we studied were in a state of transition. The 1980s brought new demands and pressures that forced them to question their worldwide strategic approach and to adapt their organizational capabilities. Some seemed to be managing the transitions successfully, others were simply surviving, and a few were encountering major difficulties.

- In the branded packaged goods industry, both Unilever and Procter & Gamble responded to the need for greater scale efficiency and more globally integrated marketing strategies and technology development by providing better coordination and control over their worldwide operations. Kao, the leading Japanese consumer chemicals company, was able to use its formidable technological capabilities, scale-efficient plants, and marketing creativity to score major victories against both these competitors in its home market, yet it was unable to leverage those skills worldwide. Despite significant investments and substantial management effort, the
company's internationalization thrust stalled out in the small developing markets of neighboring East Asia.

- Turbulence in the consumer electronics industry led both Philips and Matsushita to make major readjustments over the past decade. Philips made heroic changes to its historically decentralized organization to achieve greater global-scale efficiency. More recently, Matsushita has begun to reconfigure its operations to make them more localized and responsive to host country pressures. But for General Electric, the once-cherished dream of becoming a leading player in the global consumer electronics industry was abandoned in favor of the more modest goal of defending its home-market position in televisions, radios, and other such products, based on an outsourcing strategy.
- Over the past decade, Japan's NEC used the technological changes and political upheaval in the telecommunications switching business to build a strong presence in the global marketplace. In the same period, the Swedish electronics company L.M. Ericsson successfully adapted its strategic approach and realigned its worldwide organization to protect, then build, its global-market position in telecommunications. ITT, meanwhile, floundered in this business. Despite being the second largest supplier of telecommunications equipment in the world in the late 1970s, and the leading company outside the U.S., and despite a staggering investment of over $1 billion in new switching technology, ITT was forced to abandon its attempt to enter the U.S. switching market. And it finally had to sell the crown jewel, its formidable European telecommunications business.

Why was it that some companies fell behind, while others adapted to the changing demands of international industry's competitive environment in the 1980s? The inability of certain businesses within Kao, GE, and ITT to adjust to important new demands is not presented as an example of strategic incompetence or managerial ineptitude. Indeed, all three companies are frequently cited as examples of corporate excellence. To understand the source of their problems, one must first analyze the changes occurring in the international environment, and how they affect each of these companies differently. Then it is important to study how each organization adjusted in order to understand why results have been so different from one company to the next.

Traditional Strategic Demands

Trying to distill the key strategic tasks in large and complex industries is a hazardous venture but, at the risk of oversimplification, one can make the case that until recently most worldwide industries presented relatively unidimensional strategic requirements. In each industry, a particular set of forces dominated the environment and led to the success of firms that possessed a particular set of corresponding competencies.

Rewarding Efficiency in Global Industries

Bell Laboratories' development of the transistor in 1947 paved the way for global efficiency in the consumer electronics industry. Transistors led to printed circuit boards, and then to integrated circuits, which made mass production feasible by reducing both the amount and skill level of labor required for assembly. The automation of component insertion, in-line testing, materials handling, final assembly, and packaging further reduced manufacturing costs and increased product quality. As a result of all these developments, the efficient scale for production of color televisions went from 50,000 sets per annum in the early 1960s to 500,000 sets by the late 1970s.

Meanwhile, scale economies in R&D and marketing were also increasing. State-of-the-art skills in micromechanics, micro-optics, and electronics could not be supported by revenues from a single market. Funding from global volume was essential to support the breadth and depth of expertise required by the three diverse technologies.

Furthermore, the emergence of giant chain stores caused increasing concentration in distribution channels worldwide and raised the need for marketing economies. The resulting shift in bargaining power from manufacturers to resellers changed the rules of the distribution game. Instead of delivering small lot sizes to single-store operators and recovering fairly large marketing overheads, manufacturers could ship large lot-size deliveries to giant chain outlets, but also had to operate within very low margins. Because these outlets sold on price, manufacturers could no longer rely on knowledgeable store personnel to move their merchandise. To educate the consumer and communicate product benefits, they had to invest heavily.
in advertising, and this too raised break-even volumes. Finally, local service capability, once an entry barrier to global firms, also became less important as increased product reliability reduced the need for service, and as the development of replaceable service boards practically eliminated the need for skilled service technicians.

According to some industry members, by the late 1970s the new manufacturing, research, and marketing economies meant that a global player in the color TV business needed to produce at least 2.0 or 2.5 million sets annually—forty to fifty times the minimum efficient scale in the early 1960s.

In an environment characterized by incrementally changing technologies, falling transportation and communication costs, relatively low tariffs and other protectionist barriers, and increasing homogenization of national markets, these huge scale economies progressively increased the benefits of global efficiency in the consumer electronics business. The industry gradually assumed the attributes of a classic global industry—one in which important characteristics like consumer needs, minimum efficient scale, and context of competitive strategy were defined not by individual national environments, but by the global economy.

Firms like Matsushita were ideally placed to exploit the emerging global-industry demands. Having expanded internationally much later than their American and European counterparts, they were able to capitalize on highly centralized scale-intensive manufacturing and R&D operations, and leverage them through worldwide exports of standarized global products. Such global strategies fit the emerging industry characteristics far better than the more tailored country-by-country approach that companies like Philips and GE had been forced to adopt in an earlier era of high trade barriers, differences in consumer preferences, and pretransistor technological and economic characteristics.

Building Responsiveness in Multinational Industries

If global efficiency was the dominant strategic demand in the consumer electronics industry, the consumer packaged goods business represented an interesting contrast. Traditionally, global integration of activities offered this industry few benefits. Instead, national responsiveness appeared to be the key strategic requirement.

In laundry detergents, for example, there was very little scope for standardizing products within Europe, let alone worldwide. As late as 1980, washing machine penetration varied from less than 30 percent of all households in the U.K. to over 85 percent in Germany. Washing practices varied from northern European countries, where "boil washing" had long been standard, to Mediterranean countries, where hand washing in cold water represented an important demand segment. Differences in water hardness, perfume preference, fabric mix, and phosphate legislation made product differentiation from country to country a strategic requirement.

Not only product attributes, but even marketing strategies, had to be responsive to the different conditions in different national markets. Concentration in distribution channels varied greatly—five chains controlled 65 percent of the market in Germany, but no chain controlled even 2 percent of the retail market in neighboring Italy. The possibility of using advertising and promotional tools also varied by market. In Holland, for example, each brand was allowed a maximum number of minutes of commercial television air time per annum, while in Germany the use of coupons, refunds, and similar forms of promotion was virtually blocked by national laws.

Against this strong need for differentiated approaches to each national market, global scale offered few benefits. In R&D, most of the consumer chemicals companies were involved only in formulating the final products; basic research for developing the ingredients was carried out by the chemical manufacturers. Similarly, the relatively simple operations of soap making could be carried out efficiently at a scale that could support a separate plant for all but the smallest markets. In any case, with raw material purchases accounting for 40 to 30 percent of costs, and advertising and marketing accounting for another 20 percent, development and production represented only a modest part of total costs.

This and many other industries with similar characteristics were what we call multinational industries—worldwide businesses in which the need for local differentiation made multiple national industry structures flourish. In such an environment, Unilever's multinational strategy was a natural fit—the company had a long history of building strong national companies that were sensitive to local needs.
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Exploiting Learning in International Industries

Unlike the consumer electronics industry, which was dominated by the need for efficiency, or the branded packaged goods industry, where responsiveness was the key strategic task, the telecommunications switching industry traditionally required a more multidimensional strategic capability. Monopoly purchasing in most countries by a government-owned postal, telephone, and television authority created a demand for responsiveness—a demand enhanced by the strategic importance almost all governments accord to developing local manufacturers of telecom equipment. Significant scale economies in production, and the need to arrange complex credit facilities for buyers through multinational lending agencies, required global integration and activity coordination. However, the most critical task for the manufacturers of telecom switching equipment was the ability to develop and harness new technologies and to exploit them worldwide. The ability to learn and to appropriate the benefits of learning in multiple national markets differentiated the winners from the losers in this highly complex business.

The historical diffusion of telecommunications switching technologies followed the classic international product cycle described by Vernon. In most cases, new products were developed in one of the advanced Western economies, often because of the powerful research capabilities of AT&T's Bell Labs in North America. Next, they were adopted in other developed countries, typically in European countries first, then in Japan. Once the new technology was understood, and the product design was standardized, companies in the developed nations began to export to countries using earlier-generation products. Exports were usually replaced quickly by local manufacturing in response to host government demands. After the local subsidiary developed adequate understanding of the technology, it was allowed to develop and adapt the product locally, to suit unique attributes of the local markets or to help local vendors. By this time, the next new product—an augmented version based on the same technology, or built on an altogether new technology—would be ready for transfer, and the same cycle would be repeated.

We call industries such as this one, where the key to success lies in one's ability to transfer knowledge (particularly technology) to overseas units and to manage the product life cycle efficiently and flexibly, international industries. This name reflects the importance of the international product cycle that lies at the core of the industry's strategic demands.

Recognizing that its small home market could not support the R&D efforts required to survive, L.M. Ericsson built its strategy around an ability to transfer and adapt its innovative product and process technologies to international markets. Its international strategy—sequential diffusion of innovation developed in the home market—fits the industry's requirements much better than ITT's multilateral approach or NEC's global posture.

Strategic Challenge of the 1980s: Transition to Transnationality

Our portrayal of these industries' strategic demands in the late 1970s is clearly oversimplified. Different tasks in the value-added chains of the different businesses required different levels of efficiency, responsiveness, and learning capabilities. We have charted what appeared to us to be the "center of gravity" of these activities—the environmental forces that had the most significant impact on the industry's strategic task demands.

In the 1980s, each of these industries underwent some major transitions. In all three, the earlier dominance of a single set of environmental forces was replaced by a much more complex set of environmental forces. Increasingly, firms must respond simultaneously to diverse and often conflicting strategic needs. Today, it is more difficult for a firm to succeed with a relatively unidimensional strategic capability that emphasizes only efficiency, or responsiveness, or learning. To win, it must now achieve all three goals at one time.

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Need for Multidimensional Strategic Capabilities

In the consumer electronics industry, the trends of increasing scale economies in manufacturing, R&D, and marketing persisted, and the need for global efficiency, if anything, increased. But the very success of efficient competitors contributed to a counterbalancing set of strategic influences that heightened the need for national differentiation and responsiveness. Most noticeably, host governments reacted strongly when the trickle of imported consumer electronics became a flood that upset their trade balances and threatened local industries. In the United States and Europe, antidumping suits, orderly marketing agreements, and political pressures fragmented the manufacturing operations of global companies by forcing almost all companies to set up local plants.

Consumers also reacted to an overdose of standardized global products by showing a renewed preference for differentiated products; the advent of flexible manufacturing processes fed the trend. Amstrad, the fast-growing British computer and electronics company, got its start by recognizing and responding to this local consumer need. It captured a major share of the high-end audio market in the U.K. by moving away from the standardized, inexpensive “music centers” marketed by the global firms, and offering customers a product more reminiscent of the old “hi-fi” systems. Their product was encased in teak rather than metal cabinets, with a control panel tailored to appeal to the British consumers’ preferences. Largely because of localized challenges such as Amstrad’s, Matsushita had to reverse its earlier bias toward standardized global designs and place more emphasis on differentiation of products. From fifteen models in its portable audio product range in 1980, the company increased the line to thirty in 1985; it also doubled the number of tape recorder models it produces, while sales per model have declined 60 percent.

The major industry shakeout of the past twenty years has left only a handful of viable competitors, all roughly equivalent in their potential to capture scale economies and develop responsive strategies. In the emerging environment, it is increasingly important for these companies to capture and interpret information, and to use the resulting knowledge and skills on a global basis. The growing sophistication of global competitive strategies means that knowledge gained about a competitor, and skills developed in response to its activities in one market, may be of vital importance for company units elsewhere in the world. Furthermore, with more sophisticated markets worldwide, rapidly changing technology, and shorter product life cycles, rich rewards are accruing to companies that can develop and diffuse successful innovations. In brief, a company’s worldwide organizational learning capability is fast becoming an essential strategic asset.

In the branded packaged goods industry, similarly, responsiveness continues to be a critical task, but both efficiency and worldwide learning have become more important. In the detergent business, for example, product standardization has become more and more feasible because of the standardization in the washing machine industry. Growing penetration of washing machines has also contributed, as has the increasing share of synthetic textiles, which narrows the differences in washing practices across countries. But the biggest impetus toward globalization has come from the fierce competition. Managers at P&G, Unilever, Henkel, and Colgate faced sharply rising input prices caused by the oil crisis of the mid-1970s, and the simultaneous recession in demand that made passing increased costs on to customers impossible. They found that developing standard brands, formulas, and packages created some economies in the production process. Further savings were made possible by developing common advertising and promotion approaches.

Innovations made jointly by a company’s headquarters and a number of national organizations have been the most important instrument for creating standardized products that satisfied the diverse demands of customers at acceptable cost levels. For example, P&G sells a heavy-duty liquid detergent called Tide in the United States, Ariel in Europe, and Cheer in Japan. The product was truly global in its development: It incorporated surfactant technology, developed in the company’s international technical coordination group to respond to cold water washing in Japan; water softening technology, developed at the European Technical Center to respond to the hardness of washing water in most European countries; and builder technology, developed in the United States to combat the higher soil content in dirty clothes. At the same time, however, the existence of regional development groups...
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ensured that the detergent satisfied primary requirements of customers in each country. Such successes have stimulated other global competitors, and have broadened the competitive game from one based primarily on national marketing capability to a much more complex one where local responsiveness, global efficiency, and worldwide innovation and learning are all part of the rules.

Similarly, the new digital technology, at one stroke, enhanced the need for efficiency, responsiveness, and learning in the telecommunications switching business. The increasing need for efficiency and integration is driven by soaring R&D costs that can only be supported through global volume and higher scale economies in component production. The magnitude of skills and resources required to create a new digital switch is difficult for most companies to assemble in one organizational unit, and this has made global innovations essential. At the same time, the growing strategic importance of the switch—it is now the core of a country’s information infrastructure—has enhanced its importance to national governments, thereby enhancing the need for companies to be responsive to local demands.

These transitions were not unique to the three industries we have described. Many other industries, from heavy earth-moving equipment and automobiles to photocopyers and power tools, have confronted similar environmental changes. In the emerging international environment, therefore, there are fewer and fewer examples of industries that are pure global, textbook multinational, or classic international. Instead, more and more businesses are being driven by simultaneous demands for global efficiency, national responsiveness, and worldwide learning. These are the characteristics of what we call a transnational industry.

This is not to suggest that the strategic challenges facing companies in the branded packaged goods business are the same as those confronting global competitors in the consumer electronics industry. The nature, the strength, and the mix of the three broad demands obviously vary widely. But it is true that companies in both these businesses—and many others besides—will find it increasingly difficult to defend a competitive position based on only one dominant capability. They will need to develop their strategy to a point where they can manage efficiency, responsiveness, and learning on a worldwide basis.

Responding to the Challenge: Toward Transnational Capabilities

These new demands had a profound impact on all the companies we studied. Firms whose key competencies had previously fit the dominant industry requirement found they needed to develop entirely new capabilities. Those whose strategic posture was an industry mismatch in the era of unidimensional strategic demands also faced the challenge of developing multidimensional capabilities. For many, however, there was the incentive of being able to leverage previously inappropriate organizational capabilities.

- Companies like Philips, Unilever, and ITT, which had traditionally operated in a multinational strategic mode (with responsiveness as their dominant posture), faced the challenge of developing global efficiency and improving their ability to develop knowledge and skills worldwide and diffuse it throughout the organization. Firms such as Kao, NEC, and Matsushita, on the other hand, had traditionally adopted a global strategic posture with efficiency as their trump card, and confronted the need for more national responsiveness and improved access to worldwide innovative resources and stimuli. GE, Procter & Gamble, and L.M. Ericsson had been exponents of the international product cycle model, efficiently transferring domestic innovations and expertise to worldwide operations. They faced the challenge of expanding their capability to create more global innovations while ensuring that their international operations retained the appropriate balance of responsiveness and efficiency.

The Organizational Constraint

One thing was clear. In all the companies we studied, there was either an explicit or an implicit recognition of the changing strategic task demands we have described. Even in those organizations that were lagging in their adaptation to the new demands, or that had abandoned their attempts to adjust, the issue was not a poor understanding of environmental forces or inappropriate strategic intent. Without exception, they knew what they had to do; their difficulties lay in how to achieve the necessary changes.

- Kao had been trying unsuccessfully since the late 1960s to establish a foothold in the European and
North American markets. Management recognized that a lack of responsiveness to the very different customer preferences and market structures was limiting the company's potential outside Japan. Emulating the practices of Unilever and P&G, the company created regional headquarters in Asia, America, and Europe. It also undertook a personnel development program to upgrade the skills and organizational status of its overseas groups, and to internationalize the perspectives of managers at headquarters.

However, functional managers at headquarters—the dominant group in this traditionally centralized company—saw the localization thrust as a signal to become more directly involved in overseas operations. The company failed to develop the national responsiveness it was seeking, since its established processes reinforced the strong direct control of headquarters functional staff and prevented regional and country managers from significantly influencing product development or even local product-market strategies.

- Many GE managers foresaw that superior global efficiency of its Japanese competitors would erode the company's competitive position in the consumer electronics business. It was manifest to them that GE's philosophy of building autonomous mini-GEs in each country had become inappropriate; greater integration and coordination of activities were necessary. Plans were made to develop more globally efficient operations by shifting production to Southeast Asia and developing specialized internal sourcing plants.

But, in an organization that had historically considered foreign subsidiaries appendages to a dominant home country operation, the importance and urgency of these plans were lost. It was a case of too little too late, and the company could not reverse the traditional role of international operations as sales outlets dependent on the parent. By this stage, the Japanese competitors had developed insurmountable leads in the battle for low-cost position, and GE had lost the opportunity to develop a global presence.

- Soon after Rand Araskog took over as ITT's chief executive, he committed himself to selling off many of its diverse businesses to provide the resources and management focus that would be necessary to make the company a leader in the emerging battle for domination of global telecommunications. He also recognized that ITT would have to change the way it managed this business. In particular, there was an urgent need to change the company's product development process in response to the emerging digital technology. All but the smallest national subsidiaries of the company had traditionally developed their own products in cooperation with their local post, telegraph, and telephone authorities. While this had generated multiple standards and a plethora of product varieties, the company had reaped considerable political rewards from being able to present a locally designed product to each government.

But the resources and technological capabilities required to develop a digital switch were clearly beyond the ability of any single country unit. At the same time, the trend toward deregulation had reduced the rewards of local differentiation. As a result, integrating the technological capabilities and financial resources of different national entities to design a standard global product had become a strategic imperative.

However, despite its best efforts, ITT management failed to persuade the different national units to cooperate with each other in building a standard switch. Conditioned by a long history of local autonomy, and driven by systems that measured performance on a local basis, national units strongly resisted joint efforts and common standards. Fierce turf protection led to constant duplication of efforts and divergence of specifications; total development costs ballooned to over $1 billion. The biggest problem appeared when the company decided to take the System 12 switch to the U.S. market. In true ITT tradition, the U.S. group asserted its right to develop its own product and launched a major new R&D effort, despite concerns from the company's chief technological officer that they risked developing what he called System 13. After years of effort and hundreds of millions of dollars in additional development costs, the product was still not ready for the market. Ultimately, it was this failure to create an integrated process for global product development that led to ITT's withdrawal from the telecommunications switching business.

The problems these companies faced were not caused by a lack of strategic analysis or insight, but instead by the limitations and biases in their own organizations that prevented the development of required strategic competencies. While the consequences were somewhat extreme in their cases, all the other companies we surveyed faced basically
the same kind of organizational constraints in developing the multidimensional strategic capability that the environment of the 1980s required.

The Critical Role of Administrative Heritage

Managers of all these companies have since learned that while strategic plans can be scrapped and redrawn overnight, a company's organizational capability is much more durable and difficult to restructure. There is no such thing as a zero-based organization. A company's organizational capability develops over many years and is tied to a number of attributes: a configuration of organizational assets and capabilities that are built up over decades; a distribution of managerial responsibilities and influence that cannot be shifted quickly; and an ongoing set of relationships that endure long after any structural change has been made. Collectively, these factors constitute a company's administrative heritage. It can be, at the same time, one of the company's greatest assets—the underlying source of its key competencies—and also one of its most significant liabilities, since it resists change and thereby prevents realignment or broadening of strategic capabilities.

A company's administrative heritage is shaped by many factors. Strong leaders often leave indelible impressions on their organizations, as Kenosuke Matsushita has in the company that bears his name, and as Harold Geneen has in a company that still reflects his philosophies.

- Geneen is best known for strengthening the corporate controller's function in ITT, but he also built up a strong tradition that headquarters managers could not interfere with either the strategic autonomy or the day-to-day operating decisions of national management in subsidiaries. He resisted the development of a central research function in the telecommunications business, and instead ensured that the national units controlled almost all the key resources and technological expertise of the company. He also placed the strongest managers in different national units, and held them fully accountable for their performance. This led to a distribution of resources and power that was strongly biased in favor of the area organization at the cost of central functional and business management. It was this administrative heritage that resisted subsequent efforts to achieve global integration.

Home country culture and social systems also have significant influences on a company's administrative heritage. For example, the more important roles that owners and bankers play in corporate-level decision making in many European companies led to an internal culture quite different from that of their American counterparts. These companies tended to emphasize personal relationships rather than formal structures, and financial controls rather than coordination of technical or operational detail. This management style led companies like Unilever to develop highly autonomous national subsidiaries that were managed like a portfolio of offshore investments, rather than like a single worldwide business. In contrast, Japanese cultural norms that emphasized group decision-making and commitment to long-term welfare of employees led to highly centralized management processes that resisted the growth in the resources and influence of foreign units.

- Decision-making processes based on nemawashi and ringi require close face-to-face contact among participating managers. These processes lay at the core of Kao's management systems and obstructed management's efforts to give foreign subsidiaries greater access, legitimacy, and influence. Further, a commitment to maintain and increase domestic employment impeded the company's ability to expand the activities and resources of the offshore units.

Finally, the internationalization history of a firm also influences its administrative heritage. Expanding in the pre–Second World War period of rising tariffs and discriminatory legislation, many European companies were forced to transfer most value-adding activities to their foreign subsidiaries. High tariff barriers in the 1920s and 1930s forced Philips to decentralize not only assembly but even component production; the dangers of German occupation of Holland led to decentralization of R&D; and, finally, the postwar boom further strengthened the roots of decentralization, since the war-ravaged headquarters did not have the capability to coordinate the company's rapidly growing international operations. Japanese companies faced quite the opposite situation. Making their main international thrust in the 1970s—the era of falling tariffs and transport costs, and increasing homogenization of national markets—their centrally controlled, export-based internationalization strategy represented a perfect fit with the external environment, besides being consistent with their own cultural norms and internal management
processes. American companies, many of which enjoyed their fastest international expansion in the 1950s and 1960s, grew primarily on the strength of new technologies and management processes that they had developed during the war. The creation of new products and technologies at home, and their exploitation abroad, became the core of internationalization strategies.

- While delegating most application engineering, manufacturing, sourcing, and marketing responsibilities to its foreign subsidiaries, GE kept basic research tightly centralized at home. The assumption was that a domestic operation could create new products that would then be available to foreign units for adoption and adaptation. This parent-company-as-leader mentality proved a major impediment to building a worldwide manufacturing function. It compromised the willingness of the U.S. company to rely on offshore sources, and kept it from recognizing the need to tap into the multiple centers of technological excellence that had emerged in different parts of the world.

In developing the capabilities required to cope with the complex demands of transnational industries, each of the companies we studied was confronted with the limiting constraints of its administrative heritage. Yet such limitations were not always immediately recognized. The more normal approach was to respond to new demands by emulating those competitors that were most successful in dealing with the situation. Philips's initial reaction to the growing competitive challenge from Japan was to pull product decisions and sourcing control to headquarters. This step was intended to replicate (and therefore, enable Philips to compete with) companies like Matsushita, whose global efficiency was dependent on standardized products and centralized production. Meanwhile, managers at Matsushita were extremely aware of the growing need for responsiveness, and launched a localization program aimed at enhancing the self-sufficiency and entrepreneurship of the worldwide subsidiary companies—attributes of Philips's national organizations that were greatly admired and envied in Osaka.

Initially, both approaches not only failed, but also had unfortunate consequences, primarily because they did not take into account the powerful administrative heritage of the organization that had to implement the changes. At Philips, the national subsidiaries were not only the main sources of international knowledge and skill, but also the entrepreneurial spark plugs that fired many strategic initiatives. Denying their traditional roles and diminishing their influence damaged their motivation and deprived corporate management of the benefits of their considerable resources. Instead of improving global efficiency, the action jeopardized the company's key organizational asset. Philips has since recognized that, while global efficiency has to be achieved, it must be done in a way that is consistent with its administrative heritage and that protects and indeed builds on the formidable strengths of its national organizations. Facing limited success in its localization program, Matsushita has also learned that the way to build national responsiveness is not to weaken central management, but to leverage the strengths of its centralized and culture-bound systems.

Philips and Matsushita (and many of the other companies we studied) eventually recognized the importance of both harnessing and offsetting the powerful influence of their administrative heritage as they adapted to new strategic demands. (In the companion article, we will describe some of the ways in which these companies were able to do so.) In contrast, as the earlier examples showed, the companies that were slow to adapt to the new environment never seemed to recognize the importance of their administrative heritage, and were therefore unable to leverage its strengths while counterbalancing its limitations.

Organizational Capability as Key Competence

The ability of a company to survive and succeed in today's turbulent international environment depends on two factors: The fit between its strategic posture and the dominant industry characteristics, and its ability to adapt that posture to the multidimensional task demands shaping the current competitive environment. Kaohsi's inability to succeed internationally stemmed from a poor fit between its centralized scale and technology-driven strategy in an industry that demanded a more differentiated and market-responsive approach. ITTs problems, on the other hand, were due more to an inability to adapt strongly focused organizational norms and behaviors, shaped by its unique administrative heritage, to the fast-changing, multidimensional demands of today's telecommunications industry. And GE experienced both fit and adaptation problems.
Despite the very different tasks facing the other companies in our study, in broad terms they are all moving toward a common goal, though from diverse directions. In the terminology we have adopted, they are making the transition from being multinational, international, or global companies to being transnational corporations. Obviously, these companies are not adopting a common strategy—the differences in their industry characteristics and administrative heritages prevent that. Indeed, neither a particular competitive posture nor a specific organizational form characterizes these companies. What is emerging as common to all of them is a new set of beliefs about managing across borders. Fundamental to this new mentality is the awareness of the importance of administrative heritage both as an asset to protect and as a constraint to overcome. To respond to the complexity, diversity, and dynamism of the external environment, and to build the multidimensional strategic postures that are required, each of these companies has to overcome the unidimensional bias shaped by its administrative heritage. To become a transnational, each must build a multidimensional organization capable of developing new strategic competences while protecting the existing strengths. What are the key attributes of such an organization? How can managers develop those attributes? How should such an organization be managed once it is built? These are some of the questions that we will address in the following article. ■

References


2 This research project consisted of three phases. The first aimed at identifying and describing the key challenges faced by managers of worldwide companies and documenting "leading practice" in coping with these challenges. That was also the hypothesis-generating phase, and the sample was selected to represent the greatest variety of strategic and organizational situations. In the consumer electronics industry, globalization offered the greatest benefits; in the consumer packaged products business, the forces of national responsiveness were especially strong; and in the telecommunications switching industry, both global and local forces were very important. Within each industry, we selected a group of firms that represented the greatest variety of administrative heritages, including differences in nationality, internationalization history, and corporate culture. The research sites we chose were Philips, Matsushita, and GE in consumer electronics, Kodak, Procter & Gamble, and Unilever in consumer chemicals, and ITT, NEC, and L.M. Ericsson in telecommunications switching.

In each of these companies, we interviewed a great many managers in corporate headquarters and also in a number of national organizations in the U.S., Brazil, U.K., Germany, France, Italy, Taiwan, Singapore, Japan, and Australia. In addition, we studied company documents, and also collected information about the industries and the companies from a range of external sources. This two-article series is written primarily on the basis of data collected in this first phase of the project.

In the next stage, we conducted detailed questionnaire surveys in three of these nine companies. The principal objective of the survey was to carry out a preliminary test of some hypotheses generated during the first phase of the study, to develop hypotheses more precisely, and to develop suitable instruments for testing them more rigorously. Approximately 100 managers from each of NEC, Matsushita, and Philips participated in the survey.

Finally, in the third phase of the study, the hypotheses were tested through a large-scale mailed questionnaire survey that yielded data on 720 cases of headquarters/subsidiary relations in sixty-six of the largest U.S. and European multinational corporations.

The overall findings of the project are being reported in our forthcoming book, tentatively entitled Managing across Borders: The Transnational Solution, to be published by the Harvard Business School Press.

3 The term "global," applied to industries, companies, and strategies, has been subject to widely differing definition and usage. For further discussion, see M.E. Porter, "Competition in Global Industries: A Conceptual Framework," in M.E. Porter, ed., Competition in Global Industries (Boston: Harvard Business School Press, 1986). We will use the term "global strategy" in its purest sense—one that defines product, manufacturing scale, technology, sourcing patterns, and competitive strategy on the assumption of a unified world market. It is the classic standardized product exported from a centralized global-scale plant and distributed according to a centrally managed global strategy.

4 See R. Vernon, "International Investment and International

The internationalization processes and accompanying organizational attributes of many European multinationals have been described by L.G. Franko, *The European Multinationals* (Stanford, CA: Graylock, 1976).


The issue of a management mind-set being critical to the task of managing MNCs was highlighted almost two decades ago by Perlmutter. See H.V. Perlmutter, "The Tortuous Evolution of the Multinational Corporation," *Columbia Journal of World Business*, January-February 1969, pp. 9–18.

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