Chapter Thirteen
The Organization of International Business
Opening Case

- One of world’s oldest multinational corporations
- Organized on a decentralized basis
- Annual conferences on company strategy and executive education sessions establish connections between managers
- Duplication of facilities and high cost structure a problem in new competitive environment
- 1996: introduced structure based on regional business groups
- “Lever Europe” established to consolidate the company’s detergent operation in order to reduce costs and speed up new product information
Introduction

- Organizational architecture includes the totality of a firm’s organization, including formal organization structure, control systems and incentives, processes, organizational culture, and people.

- Superior enterprise profitability requires three conditions:
  - The different elements of a firm’s organizational architecture must be internally consistent.
  - The organizational architecture must match or fit the strategy of the firm.
  - The strategy and architecture of the firm must not only be consistent with each other but they also must be consistent with competitive conditions.
Organizational Architecture

- Organizational structure refers to three things
  - The formal division of the organization into sub-units
  - The location of decision-making responsibilities within that structure
  - The establishment of integrating mechanisms to coordinate the activities of subunits

- Control systems are the metrics used to measure the performance of sub-units and make judgments about how well managers are running them

- Incentives are the devices used to reward appropriate managerial behavior
Organizational Architecture

- **Processes** are the manner in which decisions are made and work is performed within the organization.
- **Organizational culture** refers to the norms and value systems that are shared among the employees of an organization.
- **People** are not just the employees of the organization; the term refers also to the strategy used to recruit, compensate, and retain those individuals and the type of people they are in terms of their skills, values, and orientation.
Organizational Architecture

- Structure
- Processes
- People
- Incentives and Controls
- Culture
Organizational Structure

- This should be thought of in terms of three dimensions
  - **Vertical differentiation**: the location of decision-making responsibilities within a structure
  - **Horizontal differentiation**: the formal division of the organization into sub-units
  - **Establishment of integrating mechanisms**: mechanisms for coordinating sub-units
Centralization Versus Decentralization

- **Centralization:**
  - Facilitates coordination
  - Ensure decisions consistent with organization’s objectives
  - Top-level managers have means to bring about organizational change
  - Avoids duplication of activities

- **Decentralization:**
  - Overburdened top management
  - Motivational research favors decentralization
  - Permits greater flexibility
  - Can result in better decisions
  - Can increase control
Horizontal Differentiation: The Design of Structure

- Horizontal differentiation is concerned with how the firm decides to divide itself into sub-units.
- The decision is normally made on the
  - Basis of function
  - Type of business
  - Geographical area
Typical Functional Structure

- Top Management
  - Purchasing
    - Buying Units
  - Manufacturing
    - Plants
  - Marketing
    - Branch Sales Units
  - Finance
    - Accounting Units
The International Division

- Many manufacturing firms expanded internationally by exporting the product manufactured at home to foreign subsidiaries to sell.
- In time it might prove viable to manufacture the product in each country.
- The result could be that:
  - Firms with a functional structure at home would replicate the functional structure in every country in which they do business.
  - Firms with a divisional structure would replicate the divisional structure in every country in which they do business.
The International Division
Problems with the International Structure

- Potential for conflict and coordination problems between domestic and foreign operations
- Heads of foreign subsidiaries are not given as much voice in the organization as the heads of domestic functions
  - The international division is presumed to be able to represent the interests of all countries to headquarters
- Lack of coordination between domestic operations and foreign operations
- To combat these problems firms choose one of the following structures
  - Worldwide product divisional structure which tends to be adopted by diversified firms that have domestic product division
  - Worldwide area structure which tends to be adopted by undiversified firms whose domestic structures are based on functions
Worldwide Area Structure

- Worldwide area structure
  - Favored by firms with low degree of diversification and domestic structure based on function
  - World is divided into autonomous geographic areas
  - Operational authority decentralized
  - Facilitates local responsiveness
  - Fragmentation of organization can occur
  - Consistent with multi-domestic strategy
Worldwide Area Structure
Worldwide Product Divisional Structure

• Adopted by firms that are reasonably diversified
• Original domestic firm structure based on product division
• Value creation activities of each product division coordinated by that division worldwide
  - Help realize location and experience curve economies
  - Facilitate transfer of core competencies
• Problem: area managers have limited control, subservient to product division managers, leading to lack of local responsiveness
Worldwide Product Divisional Structure
Global Matrix Structure

- Helps to cope with conflicting demands of earlier strategies
- Two dimensions: product division and geographic area
- Product division and geographic areas given equal responsibility for operating decisions
- Problems
  - Bureaucratic structure slows decision making
  - Conflict between areas and product divisions
  - Difficult to make one party accountable due to dual responsibility
Global Matrix Structure

- Headquarters
- Area 1
- Area 2
- Area 3
- Product Division A
- Product Division B
- Product Division C

Manager Here Belongs to Division B and Area 2
Integrating Mechanisms

- Need for coordination follows the following order on an ascending basis
  - Localization
  - International
  - Global
  - Transnational
Impediments to Coordination

- Differing goals and lack of respect
- Different orientations due to different tasks
- Differences in nationality, time zone, and distance
- Particularly problematic in multinational enterprises with their many sub-units both home and abroad
Formal Integrating Systems

- Direct contact between sub-unit managers
- Liaison roles: an individual assigned responsibility to coordinate with another sub-unit on a regular basis
- Temporary or permanent teams from sub-units to achieve coordination
- Matrix structure: all roles viewed as integrating roles
  - Often based on geographical areas and worldwide product divisions
Formal Integrating Systems

Increasing Complexity of Integrating Mechanism

- Direct Contact
- Liaison Roles
- Teams
- Matrix Structures
Informal Integrating Mechanisms

- Informal management networks supported by an organization culture that values teamwork and a common culture
- Non-bureaucratic flow of information
- It must embrace as many managers as possible
- Two techniques used to establish networks
  - Information systems
  - Management development policies
    - Rotating managers through various sub-units on a regular basis
Informal Integrating Mechanisms
Control Systems and Incentives

- Types of control systems
  - Personal controls
  - Bureaucratic controls
  - Output controls
  - Cultural controls

- Incentive systems
  - Refer to devices used to reward appropriate behavior
  - Closely tied to performance metrics used for output controls
Factors that Influence Incentive Systems

- Seniority and nature of work
  - Reward linked to output target that the employee can influence
- Cooperation between managers in sub-units
  - Link incentives to profit of the entire firm
- National differences in institutions and culture
- Consequences of an incentive system should be understood
Performance Ambiguity

• Key to understanding the relationship between international strategy, control systems and incentive systems is performance ambiguity
  - Caused due to high degree of interdependence between sub-units within the organization
• Level of performance ambiguity depends on number of sub-units, level of integration, and joint decision making
• Descending order of ambiguity in firms
  • Transnational companies
  • Global companies
  • International companies
  • Multi-domestic corporations
## Performance Ambiguity

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Interdependence</th>
<th>Ambiguity</th>
<th>Performance Costs of Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Localization</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>International</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td>Global</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Transnational</td>
<td>Very High</td>
<td>Very High</td>
<td>Very High</td>
</tr>
</tbody>
</table>
Implications for Control and Incentives

• Costs of control
  - Time top management must devote to monitoring and evaluating performance of sub-units
  - Performance ambiguity increases cost of control
  - Creates conflicts as the costs of controlling transnational strategy are much higher
  - Cultural controls

• Incentive pay of senior managers should be linked to the entity to which both subunits belong
Processes

- Manner in which decisions are made and work is performed
  - Cut across national boundaries as well as organizational boundaries
  - Can be developed anywhere within the firm’s global operations network
Organizational Culture

- Values and norms shared among people
- Sources
  - Founders and important leaders
  - National social culture
  - History of the enterprise
  - Decisions that result in high performance
- Cultural maintenance
  - Hiring and promotional practices
  - Reward strategies
  - Socialization processes
  - Communication strategy
Culture and Performance

• A “Strong” Culture
  - Not always good
  - Sometimes beneficial, sometimes not
  - Context is important

• Adaptive cultures
  - Culture must match an organization’s architecture
  - Culture does not necessarily translate across borders
## Synthesis: Strategy and Architecture

<table>
<thead>
<tr>
<th>Structure and Controls</th>
<th>Localization</th>
<th>International</th>
<th>Global Standardization</th>
<th>Transnational</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vertical Differentiation</td>
<td>Decentralized</td>
<td>Core competency more centralized; Rest decentralized</td>
<td>Some centralization</td>
<td>Mixed centralization and decentralization</td>
</tr>
<tr>
<td>Horizontal Differentiation</td>
<td>Worldwide area structure</td>
<td>Worldwide product divisions</td>
<td>Worldwide product divisions</td>
<td>Informal matrix</td>
</tr>
<tr>
<td>Need for coordination</td>
<td>Low</td>
<td>Moderate</td>
<td>High</td>
<td>Very High</td>
</tr>
<tr>
<td>Integrating Mechanisms</td>
<td>None</td>
<td>Few</td>
<td>Many</td>
<td>Very many</td>
</tr>
<tr>
<td>Performance Ambiguity</td>
<td>Low</td>
<td>Moderate</td>
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</table>
Organizational Change

- Firms need to periodically alter their architecture to conform to changes in environment and strategy
- Hard to achieve due to organizational inertia
- Sources of inertia
  - Possible redistribution of power and influence among managers
  - Strong existing culture
  - Senior manager’s preconceptions about the appropriate business model
  - Institutional constraints such as national regulations including local content rules regarding layoffs
Organizational Change

- Change to match competitive and strategy environment
  - Hard to change
    - Existing distribution of power and influence
    - Current culture
    - Manager’s preconceptions about the appropriate business model or paradigm
    - Institutional constraints

- Principles for change
  - Unfreeze the organization
  - Moving to the new state
  - Refreezing the organization
Looking Ahead to Chapter 14

- Entry Strategy and Strategic Alliances
  - Basic entry decisions
  - Entry modes
  - Selecting an entry mode
  - Greenfield venture or acquisition
  - Strategic alliances