

Chapter 2

Theoretical Foundation and Literature Review

2.1 Multinational Corporations and Regional Strategies

In the extant literature different terms are used for MNCs. Apart from MNC, the mostly widely-used terminologies include multinational enterprise (MNE) (e.g., Rugman 2005b), transnational corporation (TNC) (e.g., Morrison and Roth 1992), and international corporation (e.g., Caves 1971). In this work we use the term MNC, as corporate multinationality – the degree of internationalization reflected in the activities of firms (Riahi-Belkaoui 1999: xiii) being organized in more than one national economy (Kreikebaum et al. 2002: 6) – effectively describes the varying geographic spread of corporate activities, which is important for the distinction of different regional strategies. Furthermore, we utilize “corporation” in this work, as this term is not used in a legal sense, like the term “enterprise”: “[...] clearly including a network of corporate and non-corporate entities in different countries joined together by ties of ownership [...] but rather according to common usage [...]” (United Nations 1973: 4).

In the explanation of regional strategies of MNCs, we want to address the criticism that much IB research “[...] focuses on the ‘why, where and how’ of the MNC, with little attention to the ‘when’ [in time]” (Eden 2009: 535). Following this research recommendation, in establishing a proper definition and terminological basis of regional strategies of MNCs, we briefly outline the main historical developments which have formed them over time.

Since the end of the Second World War, either on the basis of FDI or on trade, MNCs have increasingly penetrated international markets (Morrison and Roth 1992: 38). From the 1960s onwards, cross-border economic activity increased significantly, even breaking pre-war records (Ghemawat 2003: 150). This time was popularized as globalization, while still in the 1980s, the triad was limited to the US, Japan, and Western Europe, declaring the expansion across triad regions as the key route for MNC growth (Scholz 1998: 182–183; Westney 2006: 447). Regional strategies from the development of trading blocs did not emerge until

the 1990s – such as the EU “single market” of 1992, the foundation of the ASEAN Free Trade Area (AFTA) in 1992 and the North American Free Trade Agreement (NAFTA) in 1994 – which enabled MNCs to benefit from growing FDI opportunities inside of their own regions (Enright 2005b: 84; Krugman 1993: 58; Morrison et al. 1991: 23–24; Proff 2002: 233; Rugman and Verbeke 1998b: 115; Rugman and Verbeke 2004: 4; Westney 2006: 447). While such free-trade zones have still benefited from positive effects by external FDI (Buckley et al. 2001: 267–268; Feils and Rahman 2008: 156), the economic data shows that, at the same time, intra-regional trade and FDIs have increased significantly (Dunning 2001: 308; Rugman 2000: 114–122; Rugman 2005b: 216; Rugman and Hodgetts 2001: 334–335). By the beginning of the millennium, after “[...] the Asian financial crisis, episodes of instability in Russia and Latin America, a perceived “globalization backlash”, a global economic slowdown, and the war on global terrorism” (Ghemawat 2003: 150) – again the increasing trend towards regionalization, rather than globalization, was observed (Giddens 2001: 19; Rugman 2005b: 216). This was further supported by the fact that regional integration is an efficient substitute for alternative multi-lateral integration processes which in the case of the World Trade Organization (WTO) requires concession of all its member countries, by now more than 150 (Krugman 1993: 73; Rugman 2005b: 220–221; Rugman and Verbeke 2003b: 85; Rugman and Verbeke 2004: 5).¹ Many other influences, such as: “[...] limits to global economies of scale, regional differences in markets and employees, physical and psychic distances between regions and the corporate headquarters, regional variations in business rules and social behavior, and the heterogeneity of the economies of some regions [...]” (Enright 2005b: 84) have led to a semi-globalized world today, where the region plays a pivotal role in the cross-border integration of markets (Ghemawat 2003: 150; Ghemawat 2007b: 57; Ghemawat 2008: 30–31).

Along with these past developments, MNCs have continued to adjust their strategies and organizational designs, as well as relocate their subsidiaries, to align their product-/service-related and functional market interfaces with the requirements of their geographic markets (Doz and Prahalad 1991: 146). For the cross-border configuration of these corporate activities, regionalization does suggest MNCs should exploit their strengths and determine their competitive strategies separately for each region (Morrison et al. 1991: 26). Such regional strategies of MNCs, whether directed to their own region or to foreign regions, require a market-strategy approach tailored to regional requirements and the creation of region-based components in the MNC’s: “[...] coordination and control structure to address the specific managerial challenges in those regions” (Rugman 2005b: 196).

Recognizing both the macroeconomic environment of regionalism described above and its impact on the firm-level over the last years, we believe that two aspects of regional strategies of MNCs require further analysis.

¹For the political consequences of regionalization regarding the denationalization of countries cf. Walter and Zürn (1998: 48–58).

- The MNC itself should be further explored, in particular its strategic and organizational facets, as these have undergone significant changes in the course of regionalization over recent years. This is in line with Rugman's (2005b: 221) claim that the MNC is the appropriate unit of analysis for IB research in regional integration.
- In addition to recent scholarly work on regional strategies, their theoretical foundation should also include historical approaches and frameworks. Such a procedure takes into account the effect that regionalization has had on the academic perspective of internationalization strategies. The theoretical implications of these earlier findings have contributed to our understanding of regional strategies today. This sensitivity to, and awareness of, the nature of historical evidence is crucial for a proper interpretation of more recent research results about regionalization phenomena like the regional strategies of MNCs (Jones and Khanna 2006: 465).

2.1.1 Multinational Corporations and Their Regional Dimensions of Strategy and Organization

Historically the MNC and its strategic and organizational characteristics became central to IB research in the 1970s (Buckley 2002: 367).² Since then, MNCs have usually been described as large firms (Chandler 1990: 132; Vernon and Wells 1986: 1–2) with operations crossing national borders (Rugman 2005b: 224): “[...] that, at least to some extent, attempt to organize, coordinate and control these units in accordance with a common strategy” (Stopford and Wells 1972: 5).

The extent of coordination and control of its operations is influenced by the essential difference between MNCs and simpler organizations: the combined consequences of ***multidimensionality*** and ***heterogeneity*** (Doz and Prahalad 1991: 146). The fact that MNCs are business organizations with integrated operations across more than one nation (Bartlett et al. 2003: 2; Caves 1971: 1; Caves 1996: 1; Verbeke 2009: 3; Verbeke and Kenworthy 2008: 941), leads to a high degree of strategic and structural as well as political ***multidimensionality*** (Doz and Prahalad 1991: 146). ***Heterogeneity*** is a result of: “[...] the differences between the optimal trade-offs for different businesses, countries, functions and tasks as a function of a whole range of economic and political characteristics which differ between countries and affect individual businesses and tasks in quite varied ways” (Doz and Prahalad 1991: 146). Thus the strategies and organizational configurations of MNCs have both a multidimensional and heterogeneous nature.

²This impulse came from two directions – first, from Chandler's (1962) resource based theory and second, from the internalization approach which derived from ideas of Coase (1937) and from concepts related to Williamson's (1975) transaction cost economics approach (Buckley 2002: 367–368).

In a world of increasing regionalization, the multidimensionality and heterogeneity of *MNC strategies* is influenced by cross-border differences, depending on the firm's geographic breadth – meaning the scope of the market that is served by the MNC (Roth and Morrison 1992: 478). Taking into consideration their underlying logic of growth and competition (Chandler 1990: 131), MNCs basically have three options for value creation when responding to these regional differences: *adaptation*, *aggregation* and *arbitrage* (Ghemawat 2008: 105).

The strategic MNC dimension *adaptation* implies coping with cross-country differences by partially modifying a basic template by local changes (Ghemawat and Ghadar 2006: 619), which still leads to some economies of scale. Financed by firm-level investments, regional adaptations often imply production relocations to the most efficient subunits, resulting in regional scale economies and a review of the subsidiaries' functions (Rugman 2005b: 222). Further examples of possible levers of adaptation include product variations, a focus on certain customer segments, externalization by franchising, product designs on the basis of platforms, or innovations from business model recombinations (Ghemawat 2008: 115–130). All these adaptations aim at competitive advantages that boost MNC revenues and market share (Ghemawat 2007a: 60).

The strategic MNC dimension *aggregation* involves exploiting the similarities across several countries, by somehow overcoming their differences and as a consequence, reaping increasing returns to scale (Ghemawat 2003: 148). Regional aggregation occurs, if competitive advantages of MNCs can be deployed across national borders, but only in a limited geographic region (Rugman 2005b: 70). These intra-regional opportunities are supported by free-trade zones, tax regulations, inner-regional preferences, and currency unifications (Ghemawat 2008: 142). MNCs can realize aggregation advantages within the region by standardizing products/services and grouping processes of development and production (Ghemawat 2007a: 60).

The strategic MNC dimension *arbitrage* involves exploiting differences among countries, such as different absolute cost levels or variations in willingness-to-pay (Ghemawat 2003: 148). The advantages of regional arbitrage are realized mostly across regions (Rugman 2005b: 70), and may include an inter-regional division of the supply chain along different locations, for example: “[...] call centers in India, factories in China, and retail shops in Western Europe” (Ghemawat 2007a: 60).

Furthermore, regionalization affects the multidimensionality and heterogeneity of the *MNC organization* by adding new dimensions of product/service and/or geographical diversification (Pearce and Papanastassiou 2006: 152). Assuming hierarchical coordination methods to organize cross-national interdependencies (Hennart 2000: 72), MNCs establish increasingly complex administrative structures and enlarge their centralized planning facility for the coordination and organization of new geographical activities (Pearce and Papanastassiou 2006: 152). However, the fact that a complete central planning and management of these interdependencies in MNCs is not possible, leads to a decentralization and delegation of decision-making, which gives rise to opportunities for linkages between subunits at various locations and organizational levels (Doz and Prahalad 1991: 147). Consequently, in

the course of regionalization, the regional organization is increasingly resuming responsibilities from both centralized and decentralized units (Enright 2005a: 61). Mainly, these regional management units are responsible for the coordination of product-/service-related, geographic, and functional activities (Williams 1967: 87). In the literature, two types of such regional management centers are distinguished: *regional headquarters* and *regional offices* (Daniels 1987: 410; Enright 2005a: 66; Enright 2005b: 84; Grosse 1981: 48; Heenan 1979: 410; Lasserre 1996: 33–35; Lasserre and Probert 1998: 49; Morrison and Roth 1992: 52; Rugman 2005b: 73; Rugman and Verbeke 2004: 14; Schütte 1997: 441; Williams 1967: 87–88; Yeung et al. 2001: 158).

Both *regional headquarters* and *regional offices* are defined as offices that have: “[...] control over the operation of one or more other offices and subsidiaries in other economies or countries in the region [...]” (Enright 2005b: 84).

The central difference between these two management centers is the broadened regional management autonomy of *regional headquarters*, including the supervision of corporate planning, budgets, and performance evaluations in the region (Morrison and Roth 1992: 52). As a consequence of their high autonomy for both coordination and control, regional headquarters do: “[...] not need to make frequent referrals to the overseas parent companies” (Enright 2005a: 66).³ These referrals to the parent headquarters are more common for *regional offices*, which are rather “coordination offices” with limited staff support, who maintain their contact with subsidiaries mainly by fax and telephone, as well as frequent 1-day meetings (Morrison and Roth 1992: 52).

We agree with Ghemawat (2008: 150) that only on the basis of properly designed regional strategic dimensions, and a clear sense of how regional concepts are supposed to add value, can the coordination requirements at the regional level be specified. Therefore, in the following, we will usually use the term *regional management center*, and only if more detailed analyses are necessary for our research, we will differentiate between regional headquarters and regional offices. In such cases, given that we want to investigate regional management autonomy in this work, we follow the recommendation of Rugman and Verbeke (2001: 248) in focusing on regional headquarters, which are situated in *regional continents* such as America, Europe and Asia.

Recognizing the explanations above, we extend Rugman’s (2005b: 224) definition of a regional MNC, as: “[...] a firm with the majority of its sales inside one of the triad regions [...]”, to the following:

A *regional MNC* offers its products/services at the level of regional continents on the basis of its strategic dimensions of adaptation, aggregation, and/or arbitrage, each leading to different organizational configurations of coordination and control in regional management centers.

³Cf. Lasserre’s (1996: 33) typology of regional headquarters regarding their different roles in MNCs.

2.1.2 Regional Strategies and Their Theoretical Foundation

2.1.2.1 Overview of Strategy Models for Multinational Corporations

In the course of scholarly research about internationalization strategies over recent years, various strategy models for MNCs have been developed by different IB scholars. Their conceptualizations of strategy vary from approaches that are formulated either for the MNC as a whole or only for certain parts of the firm, such as subsidiaries. In addition, their models can be differentiated along their geographic level of strategy analysis, focusing on the “world” and/or “country” level, or the “region”. A classification of MNC strategy models according to these levels of analysis is illustrated in Fig. 2.1.⁴

The horizontal axis shows the two main fields of analysis in MNC research (Birkinshaw and Pedersen 2009: 368–369). On the vertical axis, the main strategic options of MNCs are depicted – which arise from geographic spread, cross-national integration, and local adaptation (Tallmann and Yip 2009: 327–334) – reflecting the strategic MNC dimensions of adaptation, aggregation and arbitrage.

The appropriateness of a particular MNC strategy model for our research depends on its coverage of the characteristics of regional MNCs which, according to the definition outlined above, are

Geographic level of analysis	Region	▪ <i>Triad power</i> (Ohmae, 1985) ▪ <i>Regional strategy matrix</i> (Rugman, 2005b)	
	World/ country	▪ <i>Structure-stadium model</i> (Stopford & Wells, 1972) ▪ <i>Multifocal strategy</i> (Doz, 1986; Prahalad & Doz, 1987) ▪ <i>International, multinational, global, and transnational strategy</i> (Bartlett, 1986; Bartlett & Ghoshal, 1989) ▪ <i>Diamond model</i> (Porter, 1990), <i>double diamond model</i> (Rugman & Verbeke, 1993; Rugman & D'Cruz, 1993)	▪ <i>Subsidiary strategy paradigm</i> (White & Poynter, 1984) ▪ <i>Susidiary strategy typologies</i> (Birkinshaw & Morrison, 1995)
		Whole firm	Parts of the firm
MNC level of analysis			

Fig. 2.1 Strategy models of MNCs

Source: own illustration

⁴Some strategy models may, in certain aspects, cover more than one field in the matrix of Fig. 2.1. Therefore it should be noted that our classification is based on the main focus of the strategy models presented here.

- Regional product/service offerings
- Regional adaptation, aggregation, and/or arbitrage
- Organizational implications for regional management centers

Regarding the level of our analysis, the strategy-related emphasis of our research is primarily on the MNC as a *whole firm*.⁵ The geographic level of our strategy-related analysis is the *region*.

This focus of our research, as also mentioned in the explanation of our aim of analysis,⁶ is best reflected in Rugman's (2005b: 49) *regional strategy matrix* – where both regional products/services and regional management centers are integral parts of this matrix.⁷ Furthermore, Rugman (2005b: 70, 77–78, 197, 203, 222, 235) explicitly applies the strategy dimensions of regional adaptation, aggregation, and arbitrage to generate further knowledge about his regional strategies.

In addition to the regional strategy matrix, as outlined above, we aim to consider historical developments in the IB field for our conceptualization of regional strategy. As we described previously, in the past, regional strategy was mainly affected by the regionalization of economies. This influence was effective at the level of the whole firm, introducing the “region” as a new geographic level of analysis for MNC strategies. Therefore, at the level of the MNC as a whole, we will consider three MNC strategy models in the theoretical foundation of regional strategy. First, we will consider Ohmae's (1985) concept of a *triad power* in our analysis, as the triad regions constitute the relevant geographical space for Rugman and Verbeke's (Rugman 2000: 1; Rugman 2005b: 202; Rugman and Verbeke 2004: 4) explanation of regional strategies. Furthermore Ohmae's (1985: 206, 209) MNC strategies of “insiderization” and market commitment to become a triad power suitably describe both limitations and opportunities of regional strategies along the dimensions of adaptation, aggregation, and arbitrage (Rugman 2005b: 59, 66, 233–234; Rugman and Verbeke 2004: 4). Second, we utilize Bartlett and Ghoshal's (Bartlett 1986; Bartlett and Ghoshal 1989) *international, multinational, global, and transnational strategies*, as these strategic alternatives are directly compared to Rugman's (2005b: 206–212) conceptualization of regional strategies (Rugman and Verbeke 2008c: 330), offering important insights into their specific characteristics. Third, recognizing the importance of historical IB theory, we employ the *structure-stadium model* of Stopford and Wells (1972), which represents an important antecedent to Bartlett and Ghoshal's (1989: 30–33) work (Pla-Barber 2002: 152; Rugman 2005b: 201). This theoretical approach offers insights for the

⁵It should be noted here that – while it could be argued from an organizational perspective that regional management centers are a part of the firm – we view the degree of decision-making autonomy granted to regional management centers as a managerial implication of the overall MNC strategy, formulated at the level of the firm as a whole.

⁶Cf. Sect. 1.2.

⁷For a more detailed description cf. Sect. 2.2.

explanation of the organizational aspects of regional strategy, as it shows how elements of MNC strategies during their worldwide expansion – given by foreign sales and foreign product diversity – relate to organizational implications (Wolf and Egelhoff 2002: 182).

At the level of the MNC as a whole, we will not address Doz and Prahalad's (Doz 1986; Prahalad and Doz 1987) *multifocal strategy*, as it constantly seeks a tradeoff between the conflicting demands of worldwide integration and national responsiveness, for example by coordinating collective operations, while being responsive to each local context (Doz and Prahalad 1991: 146; Roth and Morrison 1990: 544). Thus the perspective of this strategy is both global and local, but not regional. However, Doz and Prahalad's (Doz 1980, 1986; Prahalad 1976; Prahalad and Doz 1987) integration-responsiveness (IR) framework, which is grounded in the work of Lawrence and Lorsch (1967), will indirectly be considered as being an important foundation of Bartlett and Ghoshal's (2002: 7, 10) work. Furthermore we will exclude the *diamond model* (Porter 1990) and the *double diamond model* (Rugman and D'Cruz, 1993; Rugman and Verbeke 1993) from the theoretical explanation of regional strategy. This is justified by the fact that these models explain the national competitive advantage of MNCs by country-specific attributes (Asmussen et al. 2009: 42; Dunning 1993: 7; Rugman and Verbeke 1993: 72), which are already well-captured in Rugman's (2005b: 34–35, 202) concept of country-specific advantages (CSAs), which we will explore later. As a consequence of our strategy-related research focus on the MNC as a whole, instead of its parts, we will disregard the *subsidiary strategy paradigms* of White and Poynter (Poynter and White 1984; White and Poynter 1984), and the *subsidiary strategy typologies* of Birkinshaw and Morrison (1995). Regarding the empty field in Fig. 2.1, we could not identify an approach that explicitly develops a strategy model for certain parts of the firm at the regional level.⁸ An exclusion from the following theoretical foundation of regional strategy, however, does not mean that we will not sometimes draw on particular insights of these MNC strategy models, if beneficial to our research.

In the subsequent presentation of the central strategy models for this work, we follow a chronological order along their historical occurrence, as we aim to consider the sequence of knowledge development in the IB community. This procedure allows the distinction between already existing and newly developed knowledge about MNC strategies.

⁸Also in the work on regional management centers and/or regional offices (e.g., Enright 2005a: 66; Enright 2005b: 84; Grosse 1981: 48; Heenan 1979: 410; Lasserre 1996: 33–35; Yeung et al. 2001: 158), we could not identify any explicit strategy model for these parts of the firm. This might be due to the fact that the establishment of a regional organizational level is a result of the overall MNC strategy (e.g., to achieve intermediate solutions between local responsiveness and global integration) (Enright 2005a: 61). Consequently, the roles and particular functions of these regional management units are a function of the regional strategy of the MNC as a whole, which is addressed by the strategy models of Ohmae (1985) and Rugman (2005b).

2.1.2.2 The Stopford and Wells Structure-Stadium Model

Building on the work of Chandler (1962), the *structure-stadium model* of Stopford and Wells (1972: 63) describes the development of the organizational structure of MNCs while they are becoming more involved in worldwide markets (Morschett 2007: 283; Stopford and Wells 1972: 10). Along different degrees of multinationality in their expansion across borders, MNCs can follow alternate paths of structural change with varying performance implications (Stopford and Wells 1972: 79–84). The degree of multinationality is measured by two elements of MNC strategy: *foreign product diversity* and *foreign sales as a percentage of total sales* (Stopford and Wells 1972: 63). The structure-stadium model results from the interaction of these two variables, specifying four different strategic domains, each of which are associated with a different type of structure (Wolf and Egelhoff 2002: 182). Figure 2.2 illustrates the structure-stadium model.

Early in the development of their foreign activities, MNCs expand and diversify through one *international division* which is specialized for the coordination of a relatively small set of foreign operations (Stopford and Wells 1972: 21, 63; Wolf and Egelhoff 2002: 187). The MNCs' increasing cross-border expansion and/or product diversification lead to intolerable organizational stress for the international division, requiring alternate paths of structural development: the establishment of area divisions or worldwide product divisions (Stopford and Wells 1972: 64–65). *Area divisions* are geographical region structures (e.g., in the form of regional

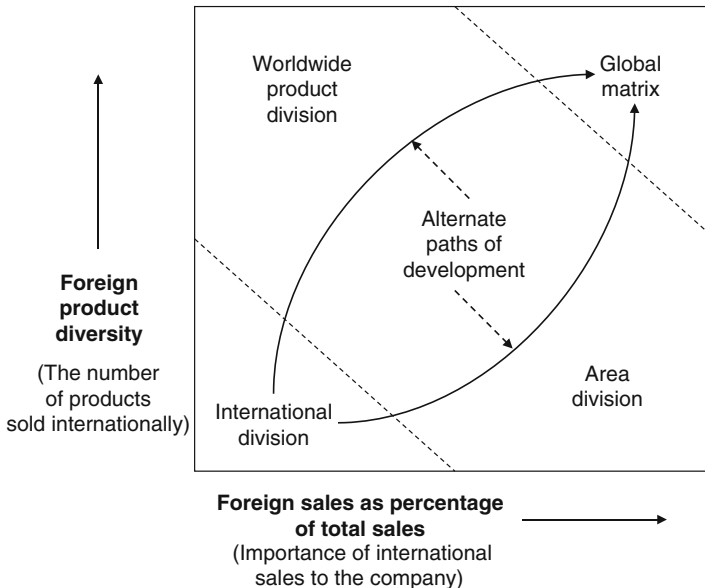


Fig. 2.2 Structure-stadium model

Source: own illustration on the basis of Stopford and Wells (1972: 63), Kreikebaum et al. (2002: 117), and Ghoshal and Nohria (1993: 23–24)

management centers) that – as an organizational response to the regional integration of production inside economic blocs – mainly coordinate and control intra-regional production, sourcing and product development (Stopford and Wells 1972: 59–60; Wolf and Egelhoff 2002: 187). However, if increases in product diversity imply higher external market diversity as well as internal technical diversity, a **worldwide product division** structure is needed, to coordinate the increasing product-related information-processing between the centers of product knowledge in the parent headquarters and the foreign subsidiaries (Stopford and Wells 1972: 41; Wolf and Egelhoff 2002: 183). At high levels of foreign sales and international product diversity, the coordination and control skills of both area divisions and product divisions are required. However, the unity of command in each of these divisions – implying isolated responsibilities and decision-making structures – leads to high inter-divisional communication barriers, which can only be overcome by the dual or multiple reporting relationships of **global matrix structures** with shared product and area responsibilities (Fouraker and Stopford 1968: 49–50; Pla-Barber 2002: 143; Stopford and Wells 1972: 27, 87).

Therefore any increases in complexity, either driven by a rise in international sales or in product diversity, imply a structural challenge to MNCs (Stopford and Wells 1972: 6). Given that the structure-stadium model of Stopford and Wells (1972: 63) – as described in the previous chapter – serves to explain the organizational challenges that result from regional strategies about regional product/service offerings,⁹ the structural implications of area and product/service divisions at the regional level form the center of the forthcoming analysis.

Area and product/service divisions represent structural alternatives, each allocating responsibility differently among senior managers (Stopford and Wells 1972: 10). Such managerial decision-making, at high levels of diversification along both product/service and geographical dimensions, is largely delegated within the MNC (Stopford and Wells 1972: 74–75). Therefore, a **high regional decision-making autonomy** is a consequence of a MNC's product/service diversification and its commitment to regional markets.

The **administration of products/services** by organizational structures **at the regional level** is encouraged to ensure a close intra-regional coordination of product/service and technical information flows (Stopford and Wells 1972: 43). The importance of such regional product/service coordination is supported by the fact that high levels of foreign R&D are associated with the geographical region structure (Wolf and Egelhoff 2002: 187). At mature stages of products/services and technologies, where marketing becomes the critical function, benefits from area coordination of products/services further increase (Stopford and Wells 1972: 43). In these cases, even though being best-suited for a single product line, area divisions may be efficiently adapted to foreign product diversification by the utilization of

⁹While Stopford and Wells (1972) describe their concepts solely in the context of products – as they do not differentiate between products and services in their work – in our explanations here, we will add the service dimension where this is appropriate and/or useful for the theoretical foundation of this work.

common functional facilities for all product lines, such as distribution channels (Stopford and Wells 1972: 80–81).

Area structures in MNCs result from a shift in the balance of power towards regional units, reflecting the impact of growing foreign activities on the geographical balance of the business (Stopford and Wells 1972: 51). Instead of area diversity per se – such as the number of foreign countries in which a MNC has manufacturing sites – only increasing foreign sales change the geographical balance of the business and thus lead to the development of area divisions (Stopford and Wells 1972: 53). At the regional level, these area divisions mainly coordinate marketing and the rationalization of production (Stopford and Wells 1972: 62, 114). The regional coordination of marketing may include a regional standardization of brand names, image, advertising, and uniform terms of sale and service (Stopford and Wells 1972: 56–57). The regional rationalization of production, accompanied by a standardization of quality and product mix, leads to lower manufacturing costs (Stopford and Wells 1972: 60–61, 115). Besides these activities, regional management groups are responsible for planning the allocation of production and markets, thereby coordinating and controlling inter-regional transfer pricing (Stopford and Wells 1972: 59).¹⁰

The analysis above shows that regional MNC strategies are associated with regional *product/service structures* to *administer technical and R&D related information*, and with *regional area structures* to *coordinate marketing and production*. The establishment of such product/service divisions and area divisions at the regional level should always be in line with the overall regional MNC strategies of diversification and geographical expansion. Such a *match between strategy and structure* give MNCs a performance advantage over other firms, whose structural characteristics are not well-tailored to strategic and managerial needs (Stopford and Wells 1972: 82, 84). Regarding the direction of this fit between strategy and structure, Stopford and Wells (1972: 5–6) view limitations of their principal assumption that “structure follows strategy” (Chandler 1962: 383) – where organizational structure has to meet the administrative requirements of strategy – as they notice that reorganizing costs and resisting interest groups may inhibit the introduction of MNC strategies.

The structure-stadium model has been largely confirmed and, in some cases, extended by subsequent research (Daniels et al. 1984, 1985; Davidson and Haspeslagh 1982; Egelhoff 1982, 1988a, b; Franko 1976; Pla-Barber 2002), while supporting its underlying principle of a fit between strategy and structure (Pla-Barber 2002: 154; Wolf and Egelhoff 2002: 182). However, the structure-stadium model has been criticized regarding four aspects. First, even though being descriptive in nature, it was utilized prescriptively by consultants, academics, and

¹⁰Area-based organizations mainly employ wholly-owned subsidiaries instead of joint ventures, while product divisions are associated with both types of ownership (Stopford and Wells 1972: 147–148).

managers, fostering the belief that every major strategic problem had a structural solution of simplistic choices between “centralization” and “decentralization”, or between product- and geography-based structures (Bartlett 1986: 368; Bartlett and Ghoshal 1989: 29–31; Kreikebaum et al. 2002: 121). Secondly, the global matrix in particular was criticized, as its dual chains of command and reporting relationships implied overlapping responsibilities, which routinely cause duplicated communications, costly and time-consuming approval processes, frequent meetings and regular intra-organizational travel (Bartlett and Ghoshal 1989: 31–32, 200). Third, Stopford and Wells (1972) fail to address a detailed and critical discussion of the direction of the fit between strategy and structure (Kreikebaum et al. 2002: 121–122), which would have contributed to a better understanding of the organizational dynamics of their four structural alternatives. Fourth, most importantly and compounding the previous point, the model focuses on only one element in the fit between structure and strategy, the formal structure of the MNC – representing solely the organizational anatomy of the firm (Bartlett and Ghoshal 1989: 201; Ghoshal and Nohria 1993: 24; Kreikebaum et al. 2002: 151) – that: “[...] could not capture the complexity of the strategic task facing the worldwide company” (Bartlett and Ghoshal 1989: 32). Consequently Stopford and Wells (1972) consider only static elements of the internal firm structure – such as roles, responsibilities, and relationships – in a dynamic and rapidly developing task environment of MNCs (Bartlett and Ghoshal 1989: 32), thus they fail to address the external context in the conceptualization of their organizational models (Kreikebaum et al. 2002: 122).

Recognizing this criticism, this work uses the structure-stadium model mainly as an orientation for the configuration of an organization (Kreikebaum et al. 2002: 121), particularly concerning the main functions of product/service and geographical area structures at the regional level, as these represent organizational implications of a regional strategy.

2.1.2.3 The Ohmae Triad Power

Ohmae (1985: 9) observes a concentration of the most important industries worldwide in a *triad*, a geographical space consisting of Japan, the US, and Europe. These triad markets share many commonalities, such as low macroeconomic growth, similarities in customer demand and in technological infrastructures, large capital and knowledge intensive MNCs, and protectionist pressures (Ohmae 1985: 3, 23–25; Rugman and Verbeke 2004: 4).

Furthermore, Ohmae (1985: 45) recognizes that while MNCs have a very solid competitive position within their own triad region, they experience difficulties in repeating their home triad performance in foreign triad markets, a phenomenon which he calls *global impasse* (Ohmae 1985: 36). This results from the dilemma that for MNCs, building market share in foreign triad markets involves high risks from enormous upfront investments and fixed costs – for setting up a distribution network and for developing strong products – while conversely, if successfully sold

at home, such so-called “superproducts” could be easily copied and sold by competition in major markets (Ohmae 1985: 39; Rugman 2005b: 59). For non-capital intensive products/services, such upfront MNC efforts are rather related to the establishment of time-honored, trust-based relationships with customers (Ohmae 1985: 40). Global impasse therefore illustrates limitations of exploiting differences across regions by a strong product/service, the *arbitrage* dimension of regional MNC strategies.

To overcome these limitations of a market dominance restricted to the home region, Ohmae (1985: 165) recommends MNCs to become a *triad power* that: “[...] has (1) equal penetration and exploitation capabilities, and (2) no blind spots in each of the triad regions [...]”. With regards to the first point, an equal and deep penetration into each triad region, is required for recovering the firm’s product-related costs and investments (Ohmae 1985: 165), particularly for R&D and distribution (Ohmae 1985: 12–13). As for the second point, the non-existence of blind spots is important to avoid surprising moves by foreign or domestic competitors (Ohmae 1985: 165), and to benefit from a global-scale utilization of strong worldwide brands and distribution channels (Hamel and Prahalad 1985: 142; Rugman and Verbeke 2004: 4). MNCs can achieve this *aggregation* dimension of regional MNC strategies via a “sprinkler model”, meaning a rapid flooding of their key markets by selling their products/services simultaneously all over the globe (Ohmae 1985: 17, 32).

A triad power combines the above described aggregation dimension with an *adaptation* dimension of successfully establishing an *insider position* in all triad markets (Ohmae 1985: 209). One reason behind such insiderization for MNCs is to become relatively independent of protectionist barriers (Ohmae 1985: 30), or even to influence governmental policies in foreign regions (Ohmae 1985: 84). Even non-tariff barriers from structural and cultural differences between triad regions – such as distinct distribution systems, different business practices, value systems and preferences, and/or languages – can be overcome by insiders, especially in the long run (Ohmae 1985: 89, 92, 100–101; Ohmae 1989a: 158).

MNCs can achieve such a long-term approach by their *staying power* as an insider, reflecting their commitment, creativity and competitiveness (Ohmae 1985: 110–111). *Commitment* is related to time, money, and effort of MNCs, while *creativity* stands for groundbreaking approaches to structural and cultural differences such as innovative distribution systems (Ohmae 1985: 111–113). Meanwhile *competitiveness* results from establishing a MNC’s overseas business like a new company with a novel business strategy (Ohmae 1985: 113–114). Their significant presence in all triad regions as a staying power with a well-established business model covering all corporate functions – being highly responsive to local and regional customers and conditions by active communication, and the autonomous decision-making of a continuous regional management – are necessary conditions for MNCs to reach a robust insider position in foreign regions (Ohmae 1985: 206; Ohmae 1989a: 155). It takes years to establish such a full business system with competent managers that are familiar with regional customer needs and the key linkages and relationships with the environment (Ohmae 1985: 51, 77).

From an organizational viewpoint, MNCs can become such an insider by consortia and joint ventures (Ohmae 1985: 171–180; Ohmae 1989b: 154; Rugman 2005b: 233) or through wholly owned units, while in the latter case they should establish regional headquarters – each with a geocentric mentality focusing on both worldwide and local objectives (Perlmutter 1969: 13) – in every respective triad region (Rugman and Verbeke 2004: 4–5).¹¹

In addition to these triad markets, Ohmae (1985: 121) adds a fourth, developing region to the relevant geographical space of MNC strategies. The resulting four-headed triad constitutes Ohmae's (1985: 121–123) *tetrahedron model*, in which US MNCs should focus on South America, European MNCs on Africa and the Middle East, and Japanese MNCs on Asia in their selection of the fourth region.¹² All four regions are covered by a *multi-regional company* with its regional headquarters in the critical tetrahedron regions (Ohmae 1985: 184). This structure involves *aggregation* advantages, as common functions can be shared in and across the regions, in: "[...] such a way as to gain synergistic advantage over competitors' quality and cost position" (Ohmae 1985: 184). At the same time however, in the *adaptation* of products/services according to the requirements of foreign triad customers, MNCs should be sensitive regarding the amount of modification (Ohmae 1985: 104–105). These adaptations, given the fact that a differentiation of upstream functions – such as purchasing and production – is not possible, have shifted downstream to the customer, where the source of differentiating products lies in: "[...] image, logistics, distribution, service, and [the] degree of perfection in execution" (Ohmae 1985: 32). To realize the appropriate degree of aggregation and adaptation, MNCs should divide their functions – for each of their tetrahedron regions – among corporate headquarters, regional headquarters, and country management (Ohmae 1985: 185–186), as illustrated in Fig. 2.3.

The light grey shaded area in Fig. 2.3 represents the functions of regional headquarters of multi-regional MNCs. Exemplary for the manufacturing function, the corporate headquarters focuses on the transfer of production technology, whereas country subsidiaries are responsible for productivity control and labor relations. The regional headquarters centrally coordinates the capital expenditure plan at the regional level, while synchronizing the sourcing of the production plan with inner-regional decentralized units. The white shaded areas show such benefits of centralization and decentralization for country subsidiaries and corporate headquarters, along the different value chain functions.¹³ Dividing the multi-regional MNC's functions into support activities, as well as upstream and downstream functions (Ohmae 1985: 34; Porter 1985: 37; Porter 1986: 21, 24), shows that

¹¹Ohmae (1985: 123) describes this mentality as an "Anchorage perspective" of a corporate center being symbolically located in Anchorage (Alaska), and thus being equidistant from the economic and political centers of the triad regions in Japan, the US, and Europe (Rugman and Verbeke 2004: 4).

¹²For general directions given to MNCs from developing regions in their triad-oriented expansion cf. Ohmae (1985: 160–161).

¹³For a detailed description of different roles of world headquarters cf. Ohmae (1985: 194–204).

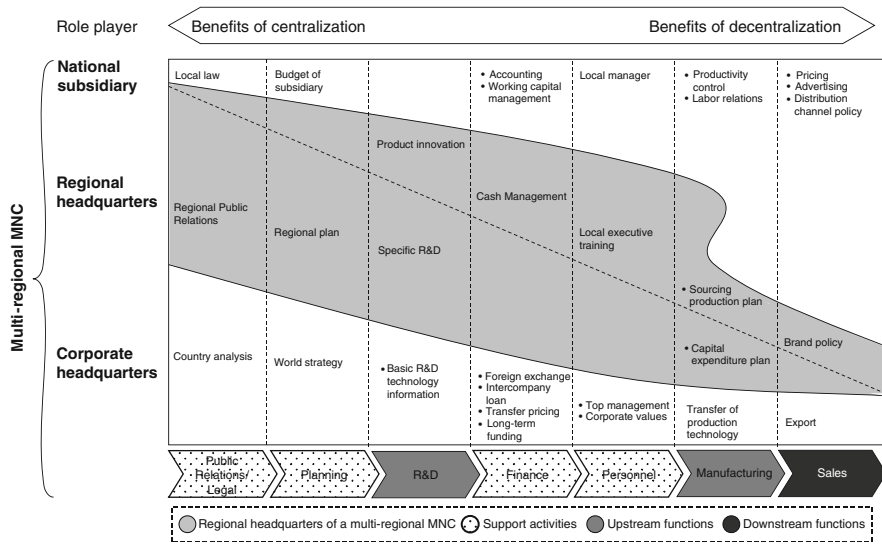


Fig. 2.3 Multi-regional division of labor
 Source: own illustration on the basis of Ohmae (1985: 186)

moving down the value chain, an increasing level of management autonomy is granted to the regional headquarters and particularly to the national subsidiaries.

To prevent regional headquarters from becoming: “[...] an extra layer of control and/or a bureaucratic nuisance” (Ohmae 1985: 188), its use should be determined by an analysis of the consumers’ product/service preferences and their degree of worldwide universality, thereby deriving the main implications for the MNCs’ key functions (Ohmae 1985: 189, 191). Such an analysis highlights opportunities of regional strategies along the dimensions of *adaptation*, *aggregation*, and *arbitrage*. For example, regional aggregation benefits may arise from commonalities in the triad customers’ basic product/service requirements – allowing the utilization of basic modules and concepts – leading to economies of scale and competitive cost advantages (Ohmae 1985: 189–190). By a careful evaluation of its strategy dimensions, a multi-regional MNC can realize a high payoff from an insider position in the triad markets (Ohmae 1985: 119).

Even though Ohmae’s (1985) findings have been criticized for not considering the development of the broad triad of NAFTA, the expanded EU, and Asia in his tetrahedron model (Rugman and Verbeke 2004: 5), his insights and concepts lay important foundations for Rugman and Verbeke’s (Rugman 2005b: 59–62, 202; Rugman and Verbeke 2004: 4–6) analysis of regional strategies, and thus represent crucial research contributions for this work.

Despite recognizing the importance of Ohmae’s (1985) approach for the conceptualization of regional strategies, he explains MNC strategies solely in the light of triad-based expansion patterns. Alternative strategies of worldwide operating

MNCs, however, receive little attention, or explicit theoretical foundation. This will be presented in the following approach for strategy models of MNCs.

2.1.2.4 The Bartlett and Ghoshal Integration-Responsiveness Framework

Building on Chandler (1962), Vernon (1966), Lawrence and Lorsch (1967), Stopford and Wells (1972), and on the IR model of Doz and Prahalad (Doz 1986; Prahalad and Doz 1987), Bartlett and Ghoshal (Bartlett 1986; Bartlett and Ghoshal 1987a, b, 1988, 1989; Ghoshal 1987) describe how external forces for *global integration*, *national responsiveness*, and *worldwide learning* shape both the internal strategic approaches, and organizational structures and processes of MNCs (Bartlett and Ghoshal 1987b: 7; Bartlett and Ghoshal 1989: 3; Bartlett and Ghoshal 2002: 10–11; Buckley 2002: 369; Kreikebaum et al. 2002: 148).

The forces for *global integration* emerge from a worldwide homogenization (Levitt 1983: 102) and convergence of consumer tastes, falling transportation and communication costs, and new economic, social and technological developments which offer MNCs competitive *aggregation* advantages from considerable global economies of scale, experience curve effects, and/or economies of scope (Bartlett and Ghoshal 1987b: 8; Bartlett and Ghoshal 1989: 5–6; Ghemawat 2003: 149; Kreikebaum et al. 2002: 148). Examples of how MNCs can achieve these global efficiencies include standardization and rationalization of their products and processes, and specialization of their manufacturing operations (Bartlett and Ghoshal 1989: 5; Kreikebaum et al. 2002: 148).

The forces for *national responsiveness* originate from different conditions in distinct national markets, where MNCs can achieve competitive *adaptation* advantages by offering locally differentiated products/services, thus being responsive to the needs and requirements of consumers and governments in national markets (Bartlett and Ghoshal 1987b: 9; Bartlett and Ghoshal 1989: 8–9; Ghemawat 2008: 113). This flexibility to adapt to multiple national markets and local conditions can be achieved by flexible manufacturing and a significant local presence, to critically observe national markets and to ensure a high sensitivity to local market differences (Bartlett and Ghoshal 1989: 8–10; Kreikebaum et al. 2002: 148).

The forces for *worldwide learning* result from the increasing cost of R&D, shortened life cycles of technologies, and local content regulations, which together require MNCs to internationally develop and diffuse worldwide innovations, to quickly amortize their heavy R&D investments over global volume (Bartlett and Ghoshal 1987b: 10; Bartlett and Ghoshal 1989: 12). MNCs achieve worldwide learning by linking and leveraging knowledge in multiple national markets, thus realizing competitive *arbitrage*, *adaptation* and *aggregation* advantages (Ghemawat 2007a: 63): “[...] by sensing needs in one country, responding with capabilities located in a second, and diffusing the resulting innovation to markets around the globe” (Bartlett and Ghoshal 1989: 12).

These external forces, both separately and in combination, lead to conflicting strategic demands that require different internationalization strategies of MNCs



Fig. 2.4 Global integration-national responsiveness framework
Source: own illustration on the basis of Bartlett (1986: 377), Bartlett and Ghoshal (1989: 65, 97), Ghoshal (1987: 429), Gilbert (1998: 47), and Kreikebaum (1997: 257)

(Bartlett and Ghoshal 1989: 14–16). This is illustrated in Bartlett and Ghoshal’s (Bartlett 1986: 377; Bartlett and Ghoshal 1989: 65, 97; Ghoshal 1987: 429) *global integration-national responsiveness framework* (Gilbert 1998: 47; Kreikebaum 1997: 257), as illustrated in Fig. 2.4.

Responding to worldwide learning forces, MNCs with *international strategies* exploit the knowledge and capabilities developed at the parent headquarters by their transfer and adaptation to overseas markets (Bartlett and Ghoshal 1987b: 10; Bartlett and Ghoshal 1989: 15). In this process, instead of leaving adaptations to autonomous and independent national subsidiaries, international companies mainly build on a strong functional management which establishes worldwide standards and specifications for the rapid cross-border diffusion of new products/services (Bartlett and Ghoshal 1989: 13–15, 137).

MNCs achieve a much higher sensitivity and responsiveness to national differences by *multinational strategies*, with strong national entities in multiple markets that largely manage their local businesses independently (Bartlett 1986: 371; Bartlett and Ghoshal 1987b: 9–10; Bartlett and Ghoshal 1989: 14). Therefore multinational companies employ a strong geographic management to identify and flexibly respond to local opportunities on a country-by-country basis (Bartlett and Ghoshal 1989: 137).

MNCs with *global strategies* aim to exploit an integrated and unitary world market by the realization of cost advantages at highly centralized global scale operations (Bartlett 1986: 371; Bartlett and Ghoshal 1987b: 9; Bartlett and Ghoshal 1989: 14–15). The centralization of strategic and operational decisions in global companies results in a dominance of business management to rationalize manufacturing, to standardize products/services, and to achieve low-cost global sourcing (Bartlett and Ghoshal 1989: 15, 137).

In contrast to the three internationalization strategies previously outlined, which cope with a single dominant strategic MNC demand (Bartlett and Ghoshal 1989: 16), a *transnational strategy* aims to simultaneously achieve global efficiencies, multinational responsiveness and flexibility, and worldwide transfers of parent company knowledge and competencies (Bartlett 1986: 372; Bartlett and Ghoshal 1989: 25). This primarily implies an organizational challenge for transnational companies (Bartlett and Ghoshal 1989: 16), as multidimensional strategic capabilities have to be developed, to properly exploit and complementarily manage multiple sources of competitive advantages from *adaptation*, *aggregation*, and *arbitrage* (Bartlett 1983: 145–146; Bartlett and Ghoshal 1989: 33; Ghemawat 2008: 218).

According to Bartlett and Ghoshal (1989: 33), the MNC's ability to develop and manage the *new* strategic capabilities highly depends on its *administrative heritage* which is defined as the MNC's: "[...] *existing* organizational attributes – its configuration of assets and capabilities, built over the decades; its distribution of managerial responsibilities and influence, which cannot be shifted quickly; and an ongoing set of relationships that endure long after any structural change". The administrative heritage of MNCs is mainly shaped by leadership, home country culture, and organizational history (Bartlett and Ghoshal 1989: 41). The effect of the latter, organizational history, on administrative heritage and management traditions is illustrated in Table 2.1 and will be explained in more detail, as this work aims to address historical developments.

During the inter-war period, many *European* MNCs applied a *multinational* organization model in their cross-border expansion, a *decentralized federation* with decentralized assets and responsibilities in nationally self-sufficient units, each exploiting local opportunities and generating knowledge independently (Bartlett 1986: 372–373; Bartlett and Ghoshal 1989: 49, 65). These firms typically applied *socialization* as a means of coordination, where negotiations between knowledgeable groups – who share common objectives, values, and perspectives – were preferred over authoritarian decision-making processes (Bartlett and Ghoshal 1989: 69, 163).

During the post-war period, many *American* MNCs expanded by an *international* organization model, a *coordinated federation* with centralized core competencies at the parent company, which were the basis for transferring knowledge and expertise to overseas operations (Bartlett and Ghoshal 1989: 49–50, 65). To coordinate their units, these companies largely utilized *formalization* – establishing formal systems and procedures – to realize operating efficiencies by decision-making routines (Bartlett and Ghoshal 1989: 69, 161).

From the mid 1960s to the late 1970s, *Japanese* MNCs utilized the *global* organizational model, a *centralized hub* with centralized assets, knowledge, and responsibilities to build global economies of scale at their corporate headquarters, based on the market reach of overseas operations (Bartlett 1986: 372–374; Bartlett and Ghoshal 1989: 51, 65). These firms coordinated their units mainly by *centralization* – substantial decision-making and interventions by the corporate headquarters' management group – which limited the role of overseas firms to implementing the parent company's strategies (Bartlett and Ghoshal 1989: 65, 69, 158).

Table 2.1 Administrative heritage and management traditions

Environmental trends	Administrative heritage and management traditions			
	Inter-war period	Post-war period	Mid 1960s to late 1970s	1980s to beginning of 1990s
MNC strategies	National market differences Transport/communication barriers	Post-war reconstruction Transfer of new technologies	Falling trade barriers Homogenizing markets	End of Cold War Intensified integration of world markets
	Rising protectionism	Leverage management skills	Improved transport, communications	Consolidation of industries
	<i>Multinational strategy:</i> Internationalize through rationally differentiated and responsive strategies	<i>International strategy:</i> Internationalize through a transfer of technological and managerial innovations	<i>Global strategy:</i> Internationalize by capturing global scale advantages	<i>Transnational strategy:</i> Internationalize by simultaneously realizing global economies of scale and national responsiveness
MNC organization models	European MNC expansion by multinational organization model (decentralized federation)	American MNC expansion by international organization model (coordinated federation)	Japanese MNC expansion by global organization model (centralized hub)	Regional expansion by regional organization model (regional management center)
				Asian financial crisis Global terrorism <i>Regional strategy:</i> Internationalize by realizing regional adaptation, aggregation, and/or arbitrage advantages

Source: own illustration on the basis of Bartlett and Ghoshal (1989: 45–55), Bartlett et al. (2003: 342–348), Rugman (2005b: 192, 197), Ghemawat (2003: 148–150), Ghemawat (2007b: 59), and Enright (2005b: 84)

From the 1980s onwards, Bartlett and Ghoshal (Bartlett 1986: 380–381; Bartlett and Ghoshal 1987a: 44; Bartlett and Ghoshal 1989: 59–61, 65) view an increased necessity of *MNCs* to combine the above described multinational, international, and global approaches by expanding transnationally – based upon a *transnational* organizational model, an *integrated network* with centralized and decentralized, interdependent and specialized assets and responsibilities of both national units and integrated worldwide operations (Kreikebaum et al. 2002: 149). A transnational MNC selectively applies *centralization*, *formalization*, and/or *socialization* – along businesses, functions, areas, and tasks – as coordination mechanisms (Bartlett and Ghoshal 1989: 69–70; Ghoshal 1987: 438).¹⁴ This gives MNCs the flexibility to simultaneously optimize economies of scale, scope and factor costs, to provide responsive reactions to local environments, and to share and develop knowledge jointly worldwide (Bartlett and Ghoshal 1988: 73; Bartlett and Ghoshal 1989: 59–60, 65).

Therefore any changes in competitive strategies or in formal organizational structures should be accompanied by matching changes in the MNC's values and management processes (Bartlett and Ghoshal 1989: 54). In such decisions about organizational configurations, the opportunities and limitations of a particular MNC's administrative heritage have to be considered on equal terms with economic, political, or any other environmental pressures (Bartlett and Ghoshal 1989: 81). Consequently, according to the *environment-strategy-structure paradigm* of Bartlett and Ghoshal (1989: 53), superior MNC performance primarily results from a: “[...] good fit between corporate strategy and environmental demands, and between organization structure and strategy” (Bartlett and Ghoshal 1989: 53), which has been confirmed by empirical research (Ghoshal and Nohria 1993: 32–33).

Criticisms of Bartlett and Ghoshal's (1989) work mainly focus on the high difficulties in building transnational capabilities – such as varying requirements of different organizational structures, costly and time-consuming socialization mechanisms, complications in decomposing interdependent MNCs into national units with different roles (Rugman 2005b: 195–196; Rugman and Verbeke 2008b: 306), duplications of competencies, and complex coordination processes (Kreikebaum et al. 2002: 152). This might be explained to a large degree by the fact that Bartlett and Ghoshal (1989) studied MNCs in the sense of business divisions (Bartlett and Ghoshal 2002: 20), where such transnational capabilities can be developed more easily than for the whole firm. Consequently, and particularly regarding the changes from 1980 to 2000, Bartlett and Ghoshal (2002: 9) state that: “[...] many of the old models, concepts, and frameworks that [they] developed to describe the workings of an earlier model of MNC no longer prove as powerful and robust as they once did”.¹⁵

This work supports their insight with Table 2.1, reasoning that *most MNCs* today – driven by the increasing regionalization and *inter-regional distance* over recent

¹⁴For a conceptualization of differentiated subsidiary roles and responsibilities in a transnational organization cf. Bartlett and Ghoshal (1989: 105–111) and Kreikebaum et al. (2002: 150).

¹⁵Here it should be noted, that Bartlett and Ghoshal (1989: 142) recognized the existence of regional headquarters and regional offices, without however further conceptualizing their implications for MNCs and their strategies.

years – tend to follow **regional strategies** to selectively exploit adaptation, aggregation, and/or arbitrage opportunities within regions (Ghemawat 2001: 140; Ghemawat 2003: 148–150; Ghemawat 2005: 107–108; Ghemawat 2007a: 60; Ghemawat 2007b: 59; Ghemawat 2008: 105; Ghemawat and Ghadar 2006: 619–620; Ricart et al. 2004: 181; Rugman 2005b: 192, 197). These MNCs develop **regional organizational models** in the form of **regional management centers** (Enright 2005a: 66; Enright 2005b: 61–63). Therefore in the following, we will further explore regional strategies, regional management centers and their coordination mechanisms, as well as environmental developments that affect strategic and managerial issues at the regional level. The inclusion of such external trends in our analysis – given their importance for analyzing MNC performance in a **regional environment-strategy-structure relationship** – is highly encouraged by the academic IB community (Czinkota and Ronkainen 2009: 263; Verbeke et al. 2009: 157).

2.2 The Rugman Regional Strategy Matrix

2.2.1 The Development of the Regional Strategy Matrix

In the IB field, Rugman (2000: 1–2) has recognized the trend towards regionalization, based on an analysis of FDI and trade data. He shows that the economic activities of MNCs are primarily triad-based in the regions EU, NAFTA, and Asia (Rugman 2000: 114). The dominant paradigm in many MNCs are intermediate degrees of globalization (Asmussen 2009: 1192; Ghemawat 2003: 150; Rugman 2005b: 62) particularly, as the focus of their business activities is rather intra-regional – mainly directed towards their own region – than across several triad regions (Rugman 2000: 114–122; Rugman 2003b: 409). As a result, MNCs are advised to design strategies on a regional rather than a global basis (Rugman 2003c: 3; Rugman and Hodgetts 2001: 341; Rugman and Moore 2001: 68).

Following a resource-based view, Rugman (2005b: 46–48, 201–206) shows how this new geographical perspective affects **firm-specific advantages** (FSAs) of MNCs in the global integration-national responsiveness framework of Bartlett and Ghoshal (1989) in Fig. 2.4. **FSAs** are unique capabilities belonging to the firm, which are developed on the basis of either product or process technologies, marketing or distributional skills (Rugman 2000: 87; Rugman 2005b: 34; Rugman and Verbeke 2005: 12). Thus, reflecting the knowledge base for the competitiveness of MNCs, examples of FSAs include technological know-how, brand names, marketing abilities, or even firm size and industry type (Rugman 1981: 61; Rugman and Sukpanich 2006a: 357; Rugman and Verbeke 1991: 5; Rugman and Verbeke 2004: 6).¹⁶

¹⁶A routine application and recombination of these capabilities may generate FSAs in the form of the MNC's core competencies (Prahalad and Hamel 1990: 82; Verbeke 2009: 77; Zentes 1998: 179).

According to Rugman (2005b: 47), MNCs can deploy two different types of FSAs in the global integration-national responsiveness framework of Fig. 2.4, either location-bound FSAs and/or non-location-bound FSAs. **Location-bound FSAs** are firm-specific capabilities which can be exploited only in a limited geographic space (Rugman 2005b: 195). They may lead to benefits of **national responsiveness** along the horizontal axis of Fig. 2.4, if the MNC addresses local concerns in its countries served – such as national consumer tastes and governmental regulations (Rugman 2005b: 47). From this Rugman (2005b: 129) concludes that location-bound FSAs are influenced by changes in **country-specific advantages** (CSAs) of MNCs. CSAs are benefits from locating certain activities in particular countries (Rugman and Verbeke 1992: 762), as parameters exogenous to the MNC which influence its competitiveness along political, economic, cultural, and financial dimensions of countries (Rugman 2005b: 34–35; Rugman and Verbeke 2005: 12). Examples of CSAs are labor markets, country cultures, regulations, infrastructure, and natural resources such as minerals, energy, or forests (Rugman 2005b: 34–35). At the country-level, for instance, CSAs such as new patent legislations influence the location-bound FSAs of pharmaceutical firms – the technological know-how of their patented products within this national market (Rugman 2005b: 129).

Non-location-bound FSAs are internationally transferable capabilities of MNCs (Rugman and Verbeke 2001: 238; Verbeke 2009: 14). MNCs can deploy and exploit non-location-bound FSAs across borders by following a **global integration** approach along the vertical axis of Fig. 2.4 (Rugman 2005b: 47). As this implies producing and distributing their products/services of a homogeneous type and quality worldwide, MNCs – by means of non-location-bound FSAs – can generate economies of scale and scope, and benefits from exploiting national differences (Rugman 2005b: 194–195). An example of a non-location-bound FSA, if valued highly by worldwide customers, is the outstanding production quality of a automobile manufacturer – which is internationally transferable, as it is embodied in its globally exported vehicles (Verbeke 2009: 14).

By adding the regional dimension to location-bound FSAs, Rugman (2005b: 50) introduces **region-bound FSAs** as company strengths beyond the limited geographic scope of a single country. However, as these FSAs cannot be deployed globally, such a **regional responsiveness** approach of MNCs is still location-bound within the countries of a particular region (Morrison et al. 1991: 27; Morrison and Roth 1992: 45; Rugman 2005b: 50). By being regionally responsive to the requirements imposed by regional host environments, MNCs can improve their penetration of, and market success in, these host regions (Rugman 2005b: 197). Both the MNC's location-bound and region-bound FSAs may be affected by CSAs like an EU or NAFTA regulation at the regional level – while WTO, IMF, or UN policies usually act at the global level (Kolk 2005: 160; Rugman 2005b: 38; Rugman and Kirton 1998: 449; Rugman et al. 1999: 225–228; Rugman and Verbeke 1991: 4–5; Rugman and Verbeke 1998a: 821–822; Rugman and Verbeke 1998b: 123; Rugman and Verbeke 2003b: 84).

Regarding the **regional exploitability of non-location-bound FSAs**, Rugman (2005b: 47) shows that MNCs may achieve an integration approach not only at the

global, but also at the regional level. Within this regionally limited geographic space, MNCs can realize **regional integration** benefits similar to global integration benefits – such as regional economies of scale and scope (Morrison and Roth 1992: 45; Rugman 2005b: 47).

The key to regionally exploiting the above described benefits from intermediate levels of national responsiveness and global integration may be best achieved by a **regional adaptation** approach (Morrison and Roth 1992: 46; Rugman 2005b: 49, 197). This should be accompanied by a high **organizational responsiveness** of MNCs by their organizational capabilities – which are location-bound FSAs, as different strategies for each country or regional market may be required (Rugman 2005b: 48). Such sub-global responsiveness implies the allocation of considerable resources, and the delegation of substantial **decision-making** to the regional level (Rugman 2005b: 50).

Therefore, according to Rugman (2005b: 52), a proper analysis of the regional dimension in MNC strategies requires a focus on the: “[. . .] **actual extent of triad-based decision-making power** [. . .] **and/or adapted products and services** [. . .]” of MNCs. As such an analysis requires a decomposition of the MNCs’ strategic decision-making processes and their product/service offering into global, regional, and national components, a more complex analytical tool than the global integration-national responsiveness framework of Fig. 2.4 is required (Rugman 2005b: 52, 225). Consequently, Rugman (2005b: 49) introduces the **regional strategy matrix**, as illustrated in Fig. 2.5.

The **horizontal axis** of Fig. 2.5 represents the management level for strategic decision-making in the MNC’s organizational structure, being concentrated either

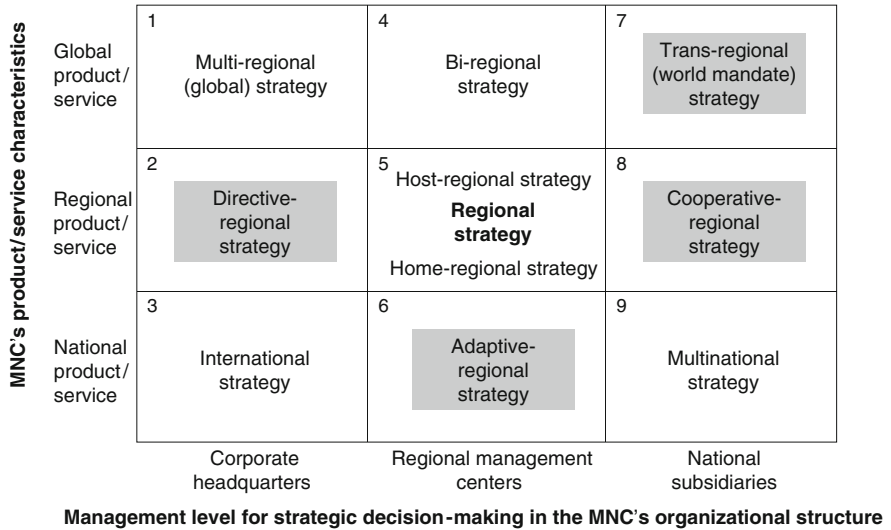


Fig. 2.5 The regional strategy matrix
Source: own illustration on the basis of Rugman (2005b: 49)

at corporate headquarters, regional management centers, or national subsidiaries (Rugman 2005b: 49, 203; Rugman and Verbeke 2006: 124–125). These different decision-making locations lead to appropriate levels of organizational responsiveness to national, regional, or global market concerns (Rugman 2005b: 49; Rugman and Verbeke 2006: 125). Thus, the decision-making locations reflect the breadth (Roth and Morrison 1992: 478) or *geographic scope* of MNCs, which is defined as: “[...] the distribution of the firm’s assets, activities, and sales across geographic space” (Rugman and Verbeke 2005: 10). The geographic scope of the MNC’s activities and operations should correspond to the locus of its competitive advantages (Rugman 2005b: 37, 182). These locational choices represent managerial reactions to locational advantages from CSAs of the firm (Rugman 2005b: 37).

In contrast, the *vertical axis* reflects the actual product/service characteristics according to the market strategies of MNCs (Rugman 2005b: 48–49, 203). Here national and regional products/services – which are adapted to national or regional requirements – are differentiated from global products/services that may be standardized on a worldwide level (Rugman 2005b: 203). These different market strategies of MNCs, pursuing either responsiveness or integration objectives, vary along the *geographic reach of their FSAs* – which can be either location-bound, region-bound and/or non-location-bound (Rugman 2005b: 37, 49, 70, 221).

Consequently in cell 5, MNCs follow a *regional strategy* which according to Fig. 2.5 is defined as *the regional adaptation of products/services and a high decision-making autonomy of regional management centers* (Rugman 2005b: 49). Within their regional environments, by means of these region-based adaptation strategies and organizational structures, MNCs can achieve both regional responsiveness and regional integration benefits (Rugman 2005b: 49–50, 201; Rugman and Verbeke 2006: 125; Rugman and Verbeke 2008b: 310). Thus the regional strategy matrix effectively illustrates a *regional environment-strategy-structure relationship*.

In addition to Rugman’s (2005b: 51) positioning of the *international strategy* in cell 3 and of the *multinational strategy* in cell 9 of Fig. 2.5 (Rugman and Verbeke 2008b: 310–311), which have been previously presented,¹⁷ the regional strategy matrix sheds light on various new strategic alternatives for MNCs – particularly different types of regional strategies.

Before going on to explain in more detail these alternative regional strategies, it should be noted that Rugman’s (2005b) approach for their conceptualization has been exposed to several important criticisms. The first criticism concerns the offering of a narrow theory of regionalization (Clark et al. 2004: 513). Related criticisms include the lack of a direct measurement of his main theoretical concepts like FSAs, or the missing details about the specific regional management forms that have worked well in certain industries and firms following regional strategies (Westney 2006: 447–448). Second, his study of regional phenomena has been criticized for being limited to triad regions, to sales-based data, and solely to the

¹⁷Cf. Sect. 2.1.2.4.

Fortune Global 500 firms (Delios and Beamish 2005: 20–23; Stevens and Bird 2004: 504–505; Westney 2006: 446). Third, methodological criticisms include his classification of regional strategies based only on 50% and 20% thresholds, and the missing differentiation of sales in the home country versus sales in the home region (Asmussen 2009: 1193; Dunning et al. 2007: 178; Osegowitsch and Sammartino 2008: 186–188; Stevens and Bird 2004: 503; Westney 2006: 446). At the same time, his critics highly acknowledge this work for pushing the IB field's attention towards regional elements (Westney 2006: 447–448), which in many MNCs: “[...] are becoming increasingly important [...], both in terms of organizational structure and market approach” (Rugman 2005b: 206). Pursuing this research avenue – after a description of different regional strategies – we further explore regional management and regional products/services.

2.2.2 *Home-Regional Strategy*

According to Rugman (2005b: 38), home-regional MNCs are firms, whose geographic reach of their FSAs and locational scope is limited to their home region. Consequently, the strategies of these MNCs are characterized by region-bound FSAs and regional management structures, placing them in cell 5 of Fig. 2.5. Based on an analysis of regional sales data for the Fortune Global 500 firms,¹⁸ Rugman and Verbeke (2004: 7) categorize MNCs as following such a home-regional strategy if they: “[...] have at least 50% of their sales in their home region of the triad”. They show that the majority of MNCs, more than 80% (or 320 firms) according to their data, are oriented towards their home region (Rugman 2003a: 1–2; Rugman 2003b: 412; Rugman 2003c: 4; Rugman 2005a: 444; Rugman 2005b: 4–5; Rugman and Verbeke 2004: 7). Their findings of a strong home-regional orientation have been confirmed for MNCs from Europe (Beleska-Spasova and Glaister 2009: 301; Oh 2009: 342; Rugman and Collinson 2005: 258; Rugman et al. 2007: 300; Yip et al. 2006: 248), North America (Hejazi 2007: 24; Moore and Rugman 2003: 2), Asia (Collinson and Rugman 2008: 216; Oh and Rugman 2007: 39; Rugman and Collinson 2006: 168; Yin and Choi 2005: 110), the emerging markets (Banalieva and Santoro 2009; Sethi 2009), and for particular industries (Girod and Rugman 2005: 335–336; Oh and Rugman 2006: 165; Rugman and Collinson 2004: 472; Rugman and Girod 2003: 32; Rugman and Verbeke 2008a: 405). An example of an industry with many home-regional MNCs is the pharmaceutical sector, with its heavily regulated markets of North America and Europe, and its institutional frameworks for distribution and marketing (Rugman 2005b: 136).

¹⁸In Rugman and Verbeke's (Rugman 2005b: 3; Rugman and Verbeke 2004: 7) study of the Fortune Global 500 firms, no data was available for 120 firms, so their actual sample included 380 firms.

In general, such investigations of home-regional strategies are based upon Rugman and Verbeke's (2004: 7) sales-based classification threshold of 50%, which we presented previously. Even though this classification threshold of 50% may indicate a substantial home-regional influence on the decisions and actions of MNCs (Rugman 2005b: 64; Rugman and Verbeke 2004: 7), the choice of this cut-off point turns the classification overly sensitive to the 50% value (Asmussen 2009: 1193; Osegowitsch and Sammartino 2008: 186). In addition, the assumption that a geographical sales concentration solely reflects priorities in decision-making and corporate actions, misses theoretical underpinnings (Osegowitsch and Sammartino 2008: 186). Home-regional sales also indicate a geographic focus in the deployment of FSAs (Osegowitsch and Sammartino 2008: 186–187), which implies a home region-specificity of the MNCs' capabilities. Thus, possibly driven by the administrative heritage of MNCs (Bartlett and Ghoshal 1989: 33; Osegowitsch and Sammartino 2008: 186), FSAs are configured primarily to penetrate home region markets, to address home region-bound customer needs. As shown in Fig. 2.5, such a home-regional strategy of a MNC should be measured by the degrees of its home-regional product/service adaptation and its organizational responsiveness to home-regional demands. Both of these influences do not act on a domestic market, but at the level of the home region. Therefore, we believe that – even though a distinction of domestic from home-regional sales might lead to a better picture of the geographic reach of FSAs within the home region (Asmussen 2009: 1201; Osegowitsch and Sammartino 2008: 187) – the level of the home region is the appropriate level of analysis for home-regional strategies. This is supported by Ghemawat's (2001: 140), Ghemawat's (2005: 100, 102) and Ghemawat's (2008: 34) analysis of different facets of cultural, administrative/political/institutional, geographic and economic distance that act on a regional level – e.g., regional trading blocs and currency unifications.¹⁹ As a result, specific home-regional FSAs and the emphasis of home-regional decision-making to address regional demands are the main influencing factors of home-regional sales. These elements of MNCs should be more explicitly emphasized in the conceptualization of their home-regional strategies. Consequently, we define a *home-regional strategy* as the *exploitation of home region-bound FSAs and the focus on home-regional decision-making, to achieve the majority of sales in the home region*.

2.2.3 Host-Regional Strategy

Rugman and Verbeke (2004: 7) show that almost 3% (or 11 firms) of the MNCs in their sample are host region oriented firms with “[. . .] more than 50% of their sales in a triad market other than their home region”. Host-regional MNCs were

¹⁹In Sect. 2.3.2.2, these different dimensions of inter-regional distance will be presented in more detail.

encountered for example in the automotive industry, where a foreign host region offered better growth opportunities than the home-regional market (Rugman 2005b: 147–148).

As the same arguments apply principally here as in the previous home-regional strategy, we define a host-regional strategy as follows: a *host-regional strategy* is ***the exploitation of host region-bound FSAs and the focus on host-regional decision-making, to achieve the majority of sales in the host region.***

As the MNC's host-regional strategies align its FSAs with host region-bound demands and requirements (Rugman 2005b: 43), they achieve a geographic reach outside of the firm's home region. Therefore, even though being host-regionally limited, MNCs following host-regional strategies realize a higher geographic reach than firms pursuing home-regional strategy. This is indicated by placing the host-regional strategy above the home-regional strategy in cell 5 of Fig. 2.5.

2.2.4 Bi-regional Strategy

Bi-regional MNCs are characterized by a significant presence in two regions, thus having a global reach for their FSAs, but no global geographic scope (Rugman 2005b: 38). Approximately 7% (or 25 firms) in Rugman and Verbeke's (2004: 7) sample are bi-regional firms with: "[...] at least 20% of their sales in each of two regions, but less than 50% in any one region". These bi-regional MNCs usually derive between 20% and 50% of their sales from both their home region and another triad region (Rugman and Verbeke 2004: 7). The financial services industry is comprised of a high amount of such bi-regional MNCs, which generally focus on North America and Europe (Grosse 2005: 129, 139).

While the threshold of 20% of sales was chosen to reflect considerable market success from FSA deployments in two regions (Rugman 2005b: 64; Rugman and Verbeke 2004: 7), the huge size of MNCs and the heterogeneity in product market sizes warrant lower cut-off points (Osegowitsch and Sammartino 2008: 188). Therefore, and again to avoid the high sensitivity to the operationalization of classification thresholds (Asmussen 2009: 1195),²⁰ we focus on those MNC strategies that achieve a *considerable part of their sales* in each of the two regions. Such bi-regional strategies are positioned in cell 4 of Fig. 2.5, as the global, non-location bound nature of FSAs is reflected in their reach beyond one particular region (Girod and Rugman 2005: 351; Rugman 2005b: 40). At the same time, bi-regional organizational structures reflect the limited geographic scope of the MNC's activities (Rugman 2005b: 40). Consequently, we define a *bi-regional strategy* as ***the exploitation of region-bound FSAs in two regions and the focus on bi-regional decision-making, to achieve a considerable part of sales in each of the two regions.***

²⁰Cf. Sect. 2.2.2.

2.2.5 *Multi-regional (or Global) Strategy*

A global MNC is present in all three triad regions with a global reach of its FSAs and a global scope (Rugman 2005b: 38). According to the data of Rugman and Verbeke (2004: 7), only slightly over 2% (or 9 firms) are global firms: “[...] having sales of 20% or more in each of the three parts of the triad, but less than 50% in any one region of the triad”. This 20% classification threshold corresponds to Ohmae’s (1985: 165) description of a triad power with a balanced presence and sales distribution across the triad (Osegowitsch and Sammartino 2008: 185; Rugman 2005b: 64; Rugman and Verbeke 2004: 7).²¹ A global strategy achieves the first condition of a triad power – equal penetration and exploitation capabilities in each triad market (Ohmae 1985: 165) – by deploying non-location bound FSAs in each of the three triad regions (Rugman 2005b: 39, 64). The second condition – the non-existence of blind spots (Ohmae 1985: 165) – is realized by a global strategy through the global geographic scope of the MNCs’ operations (Delios and Beamish 2005: 22; Rugman 2005b: 39; Rugman and Verbeke 2004: 4). As both key financial and many corporate strategy decisions are taken at the parent headquarters (Rugman 2005b: 50), global strategies are placed in cell 1 of Fig. 2.5. Many MNCs with such global strategies can be encountered, for example, in the computer, office, and electronics industry – particularly as they allow the transport of standardized components across the world (Rugman 2005b: 173).

As in this work we focus on five regions in all continents in the world, a global strategy across more than two regions can be tri-regional (three regions), quad-regional (four regions) (Delios and Beamish 2005: 22), or global (five regions). Consequently, we subsume these geographical variations of a global strategy in the term **multi-regional strategy**, while both terms are used interchangeably in this work. Recognizing the arguments before regarding classification thresholds,²² we define this strategy as *the exploitation of non-location-bound FSAs in more than two regions and the focus on central decision-making at the corporate headquarters, to achieve a considerable part of sales in more than two regions*.

2.2.6 *Further Regional Strategies*

The cells 2, 6, 7, and 8 of Fig. 2.5 represent additional regional strategies to the home-, host-, bi-, and multi-regional (or global) strategies outlined above. Even though Rugman and Verbeke (Rugman 2005b: 50–52, 204–206; Rugman and Verbeke 2008b: 310–311) described them in their work, they did not devise any wording or particular names to characterize them. Therefore, based on their

²¹Cf. Sect. 2.1.2.3.

²²Cf. Sect. 2.2.2.

description, we will proceed to develop a terminology for these regional MNC strategies.²³

Cell 2 of Fig. 2.5 combines centralized decision-making at the corporate headquarters with substantial regional responsiveness regarding the product/service offerings of MNCs (Rugman 2005b: 204–205). Here, the centralization of decision-making should predominantly focus on host-regional, and only partly on home-regional, products/services. This is due to our assumption that most frequently, the corporate headquarters should be identical to the regional management center in the home region. One reasoning behind centralizing decision-making for host-regional products/services might be a physical separation of a MNC's operations between the headquarters and a foreign host region (Rugman 2005b: 204). Another reason might be the need for a central coordination of strategic investment decisions, if substantial resources are allocated to a foreign host region (or within the home region) (Stopford and Wells 1972: 43). We term this headquarters-based coordination of host-(home-) regional product/service adaptations a **directive-regional strategy**. We define this strategy as *the exploitation of host-(or home-) region-bound FSAs in a host region (or within the home region), and the focus on central decision-making at the corporate headquarters, to achieve the majority of sales in the host (or home) region*.

To achieve decision-making synergies across markets (Rugman 2005b: 205), in cell 6 of Fig. 2.5, decisions about national product/service offerings are made by a regional management center. These decision-making synergies are realized in particular functional areas of regional management centers (Rugman 2005b: 51), for example in R&D or marketing at the pan-European level. In our view, geographically this can take two forms. First, the home-regional management center might use functional decision-making synergies for national products/services of the home region. Second, a host-regional management center might install functional decision-making synergies for national products/services of its own host region. The utilization of region-based functional synergies for a national product/service should account for its location-bound FSAs. Therefore, as a home-regional or a host-regional management center has to ensure an adaptation to national requirements, we term this an **adaptive-regional strategy**. We define this strategy as *the exploitation of location-bound FSAs and the focus on regional decision-making in either the home region or a host region, to achieve the majority of sales in the respective region*.

In cell 7 of Fig. 2.5, global products/services are delivered by powerful national subsidiaries (Rugman 2005b: 51–52). Here, the subsidiary has worldwide responsibility for a global product/service, and autonomously evaluates its market potential in national economies (Birkinshaw and Morrison 1995: 734; Ghemawat 2005: 104–105; Ghemawat 2008: 153–154; Rugman 2005b: 206). Based on this world mandate, a subsidiary usually controls all aspects of R&D, production, sales, and

²³We were able to personally accord our terminology with both Rugman and Verbeke during the IB conference at the University of Reading in the UK, 30–31 March 2009.

distribution for a limited range of global products/services (Birkinshaw and Morrison 1995; Morrison and Roth 1992: 51; Poynter and Rugman 1982: 54; Rugman and Bennett 1982: 59; White and Poynter 1984: 61). This represents a typical approach of firms in their evolution toward Bartlett and Ghoshal's (1989: 25, 65) transnational MNC (Rugman 2005b: 206; Rugman and Verbeke 2008b: 311). To emphasize that a world mandate strategy is beyond not only the national, but also the regional level, we utilize the term *trans-regional (world mandate) strategy*. As it combines cells 1 and 9 of Fig. 2.5 (Rugman 2005b: 51), we define this strategy as *the exploitation of non-location-bound FSAs and the focus on national decision-making for the products/services of more than two regions, to achieve a considerable part of sales in more than two regions*.

In cell 8 of Fig. 2.5 national subsidiaries jointly standardize their product/service offering at the regional level, thus benefiting from strong similarities in the demand of national markets within the home region or a host region (Rugman 2005b: 205; Rugman and Verbeke 2008b: 310). To realize these economies of scale and scope, subsidiary initiative is critical (Birkinshaw 2000: 8; Morrison et al. 1991: 27; Morrison and Roth 1992: 51–52; Rugman 2005b: 205; Rugman and Verbeke 2001: 238; Rugman and Verbeke 2008b: 310).²⁴ Subsidiary initiatives aim to identify opportunities to use or expand the MNC's resources (Birkinshaw 1997: 207; Birkinshaw 1998: 356; Birkinshaw 2000: 20). Thus, in cell 8 of Fig. 2.5, regional integration benefits are realized by the cooperation of national subsidiaries and their initiatives to extend the geographic reach of FSAs to the regional level (Rugman 2005b: 222). We term this strategy a *cooperative-regional strategy*, which we define as *the exploitation of region-bound FSAs in either the home region or a host region and the focus on national decision-making, to achieve the majority of sales in the respective region*.

The majority of the diverse regional strategies outlined above, particularly those in cells 2, 4, 5, 6, and 8 of Fig. 2.5 are not addressed by Bartlett and Ghoshal's (1989: 65, 97) IR framework of Fig. 2.4 (Rugman 2005b: 52). However, considerable empirical evidence has been provided by Rugman and Verbeke (Rugman 2005b: 4; Rugman and Verbeke 2004: 7) for the dominance of such regional strategies of MNCs – particularly of home-regional strategies, which are situated in cell 5 of Fig. 2.5. Consequently, the regional strategy matrix represents an important framework both in conceptual and empirical terms for the strategic alternatives of MNCs. In the following, we will further explore the regional components of structure and strategy – the former represented by regional management on the horizontal axis, the latter by regional products/services on the vertical axis of Fig. 2.5 (Rugman 2005b: 202; Rugman and Verbeke 2008b: 310).

²⁴Possibilities for a MNC to encourage its national subsidiaries to act at this regional level, beyond their national market, include judging them on their contribution to regional growth and profitability (Stopford and Wells 1972: 60), or giving the most enthusiastic subsidiary a lead for certain regional product attributes or service elements (Bartlett and Ghoshal 1989: 149).

2.2.7 Regional Management

Manifold reasons exist for installing a regional management as an additional decision-making layer in the MNC. Some argue that it reduces the complexity at corporate headquarters of managing hundreds of national subsidiaries to less than 10 regional management units (Arregle et al. 2009: 103). Therefore regional management, following a transaction cost economics argumentation (Williamson 1981, 1996), represents an efficient intra-firm regional governance mechanism for the bounded rationality and bounded reliability of MNCs (Rugman and Verbeke 2005: 9, 15; Rugman and Verbeke 2007: 201; Verbeke and Kenworthy 2008: 944). **Bounded rationality** reflects the limitations of an intended rational human behavior (Simon 1957: xxiv) to absorb, process and purposefully act upon complex and often insufficient information (Verbeke 2009: 9, 52; Verbeke and Kenworthy 2008: 954). As bounded rationality affects managers of MNCs in the exploitation of FSAs (Verbeke and Kenworthy 2008: 954), it forces corporate headquarters to delegate decisions to the regional level (Rugman 2005b: 50), where national and regional market-related information can be better captured (Buckley and Ghauri 2004: 87). Therefore bounded rationality gives reasons for a regional management presence, if MNCs set up locally-oriented activities in a distant region (Enright 2005b: 100), or if the number of distinct economies within a particular region increases (Enright 2005a: 75; Rugman and Verbeke 2005: 15).²⁵ **Bounded reliability** describes limitations of individuals regarding their realization of a promised outcome (Rugman and Verbeke 2005: 9; Verbeke 2009: 9; Verbeke and Greidanus 2009: 1482; Verbeke and Kenworthy 2008: 954). Bounded reliability of national subsidiaries is influenced by their distance to the incentive systems of corporate headquarters – including immediate sanction and reward systems, as well as monitoring and controlling mechanisms (Verbeke and Kenworthy 2008: 954; Yeung et al. 2001: 179). Therefore bounded reliability explains how the importance of regional management might be influenced by the geographical proximity to corporate headquarters (Yeung et al. 2001: 179).

In addition, MNCs need to create a *favorable organizational context* internally, and in conformity with their external environment, for deploying non-location-bound and location-bound knowledge and innovations (Verbeke and Kenworthy 2008: 944, 955). Regarding a MNC's internal organization, a regional management ensures the exploitation of synergies and the consistency of policies across the region, and it may pool functional resources (Daniels 1987: 412–413; Lasserre 1996: 31; Yeung et al. 2001: 166). With respect to the external environment of a MNC, regional management signals commitment to the region (Birkinshaw et al. 2006: 697; Ohmae 1985: 111; Yeung et al. 2001: 179),²⁶ and detects both new

²⁵An example of increases in the number of distinct economies within a particular region is given by the rising number of member states within the EU (Berger and Steger 1998: 26).

²⁶Cf. Sect. 2.1.2.3.

regional business opportunities and changes in the regional environment (Lasserre 1996: 31; Lasserre and Probert 1998: 49).

Furthermore, regional management is an organizational response of MNCs – such as the transnational type of organization by Bartlett and Ghoshal (1989: 59–61, 65) – to *balance the pressures to stay local and to globalize* (Buckley and Ghauri 2004: 86–87; Daniels 1987: 417; Enright 2005a: 78; Schütte 1997: 440–441; Williams 1967: 91; Yeung et al. 2001: 179). These two conflicting pressures affect the firm's functional activities along its value chain, as they impose the need for downstream and upstream FSAs on MNCs (Rugman 2005b: 197, 173; Rugman and Verbeke 2008b: 311). *Downstream FSAs*, or customer-end FSAs: “[...] refer to knowledge strengths deployed in activities with a direct interface with the customers, and are required to achieve successful market penetration” (Rugman 2005b: 197). These MNC capabilities are contrasted to *upstream FSAs* or back-end FSAs, which: “[...] are deployed in activities that lack this direct interface, but are critical to creating an efficient internal production system” (Rugman 2005b: 197). Regional management functions realize *adaptation* advantages by a regional responsiveness to downstream, intra-regional differences at the country level (Arregle et al. 2009: 89–90; Ghemawat 2008: 199; Schütte 1997: 441). Also at the customer-end, regional management may deploy *aggregation* advantages from capitalizing on similarities across markets and from exploiting synergies of regionally integrated national subsidiaries (Arregle et al. 2009: 89–90; Ghemawat 2003: 148; Rugman 2005b: 77). At the same time, regional management achieves back-end *arbitrage advantages* by benefiting from absolute economies across borders (Ghemawat 2008: 169; Rugman 2005b: 70); for example by reallocating investments across national boundaries (Arregle et al. 2009: 91). In addition, arbitrage leads to dispersed assets in the MNC, which may act as sources of back-end economies of scale and scope in specialized regional management centers (Ghemawat 2008: 199; Rugman 2005b: 77–78; Rugman and Verbeke 2008b: 311). Consequently, regional management may realize *revenue advantages* from downstream FSAs by the regional adaptation of products/services, and *cost advantages* both from exploiting aggregation economies of downstream FSAs and from realizing arbitrage effects regarding upstream FSAs (Buckley and Ghauri 2004: 86–87; Rugman and Verbeke 2008b: 311).

To optimally respond to the dual requirements of economic integration and national responsiveness, different functional MNC activities require varying degrees of hierarchical coordination and control (Rugman and Verbeke 1992: 769). The coordination and control of customer-end activities in the MNC is achieved mainly by *participative decentralization*, leading to a high involvement of regional management in corporate strategic planning (Freeland 1996: 484; Rugman 2005b: 74). In contrast, back-end activities are coordinated and controlled mainly by *administrative centralization*, leading to a high involvement of the corporate headquarters in regional management affairs (Freeland 1996: 484; Rugman 2005b: 74; Williamson 1975: 148).

Regional management exists and persists only if it creates value for the MNC (Enright 2005a: 62), on the basis of downstream and/or upstream FSAs.

The deployment of customer-end and back-end FSAs, however, is irrespective of a particular value chain function (Rugman 2005b: 70, 72). As a result, the geographical division of labor – given by the most important functional activities at the regional level – represents the appropriate unit of analysis for regional management (Buckley and Ghauri 2004: 94). A recent application of this approach – which has also been proposed by Ohmae (1985: 186) according to Fig. 2.3 – can be found in Enright's (2005a: 65; 2005b: 89) empirical results on the functional activities in the Asia-Pacific region of 1,100 North American, European, and Japanese MNCs. In our analysis of Enright's (2005a: 66–68; Enright 2005b: 100) work – by focusing on those functional activities which were perceived as most important by his respondents, and those which are realized at the level of regional headquarters – we could identify four categories of regional management activities: *regional strategy development, regional market and product/service development, regional market coordination, and regional operational administration*.²⁷

As outlined above, these regional management functions of MNCs require different balances of customer-end and back-end FSAs, to achieve regional responsiveness and regional integration benefits. Given the bounded rationality and bounded reliability of the management at corporate headquarters, and the need to create a favorable organizational context in the region, a *regional management* is established, which is defined as *functional activities at the regional level of a MNC in the areas of regional strategy development, regional market and product/service development, regional market coordination, and regional operational administration, which aim to achieve both downstream and upstream FSAs*.

2.2.8 Regional Products/Services

A *product* represents a bundle of technical and functional attributes that might satisfy a need or a utility of a customer (De Búrca et al. 2004: 258; Kotler et al. 2007: 12; Meffert et al. 2008: 398–399). A *service* is a form of a product consisting of intangible activities, benefits, or satisfactions that are offered for sale to a customer (Kotler and Armstrong 2004: 276; Meffert et al. 2008: 29; Onkvisit and Shaw 2009: 365). The “regional” character of a product/service depends upon the geographic reach of its embodied FSAs (Rugman 2005b: 203; Verbeke 2009: 14). More specifically, a regional product/service results either from augmenting the geographic reach of location-bound FSAs to the regional level, or from the regionally limited deployability of non-location-bound FSAs (Rugman 2005b: 200).

This is schematically illustrated in Fig. 2.6, where various combinations of triangles – each representing a possible regional product/service configuration in a MNC – show different levels of the geographic reach of FSAs.

²⁷In Sect. 4.1.1, these regional management activities will be presented in detail.

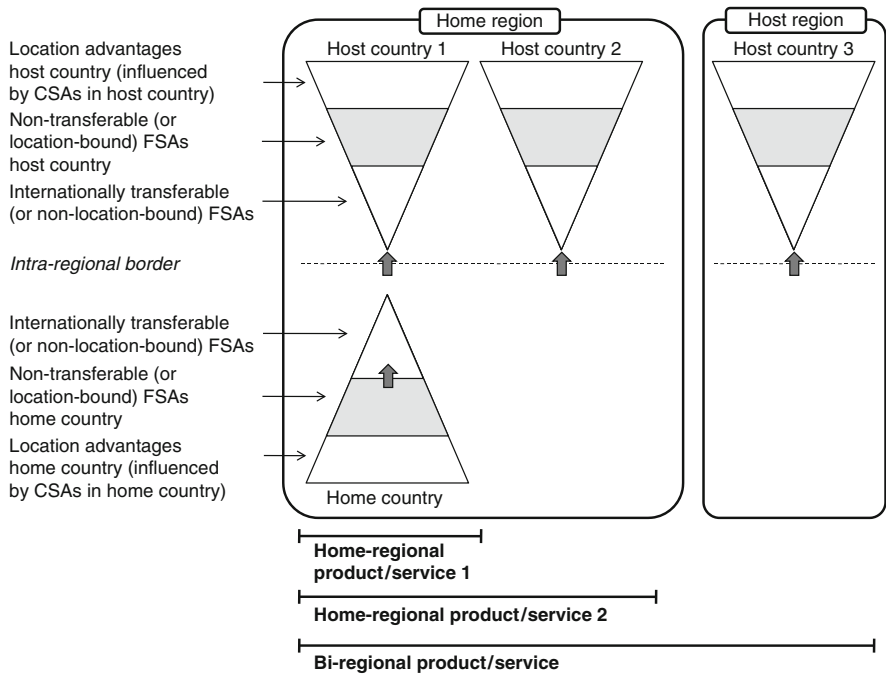


Fig. 2.6 Geographic reach of the FSAs of regional products/services

Source: own illustration on the basis of Verbeke (2009: 34)

In the case of the home-regional product/service 1, a MNC could augment its location-bound FSAs to non-location-bound FSAs – as indicated by the lower, grey shaded arrow in Fig. 2.6. These non-location-bound FSAs are then transferable to the foreign host country 1. There, the transferred (non-location-bound) FSAs of the home country are complemented by the development of new location-bound FSAs in host country 1, to access and benefit from the location advantages of host country 1 (Verbeke 2009: 34). These location advantages of the MNC in host country 1 are influenced by its CSAs in this host country – such as a skilled workforce, or good supplier networks (Rugman 2005b: 44). The home-regional product/service 1 is therefore characterized by region-bound FSAs (being located in the home country and in host country 1). In the case of the home-regional product/service 2 in Fig. 2.6 – as non-location-bound FSAs cannot be transferred beyond the home region – the same procedure leads again to region-bound FSAs in the home region (being situated in the home country, in host country 1, and in host country 2). In the case of a bi-regional product/service in Fig. 2.6, non-location-bound FSAs were successfully transferred to host country 3 in a foreign host region. Here again, to exploit the location advantages of host country 3, the MNC develops new location-bound FSAs in host country 3 as a complement of its (non-location-bound) FSAs of the home country. The resulting bi-regional product/service – even though its FSAs are region-bound within the home region and the host region – has extended the

deployability of non-location-bound FSAs beyond one particular region. This increased geographic reach of FSAs corresponds to the characteristics of a global product/service, as illustrated on the vertical axis of Fig. 2.5. Over time – in the case of all three regional products/services presented before – MNCs might also develop new, non-location-bound FSAs in their respective host countries 1, 2, and/or 3 (Rugman 2005b: 229). Depending on the geographic reach of these new (non-location-bound) FSAs, MNCs can expand the relevant market space of their products/services within a particular region, or towards a more global level. In other words, the transformation of a regional to a more global product/service is realized by changing FSAs, rather than by expanding geographic scope (Rugman 2005b: 226).²⁸

In all of the cases described above, the regional geographic reach of FSAs is a consequence of the adaptation of MNCs to national or regional market requirements (Rugman 2005b: 203, 229). The regional adaptation of products/services can take different forms, as illustrated in the overview in Table 2.2.

First, products/services could be adapted vertically (e.g., by changing their objective quality) or horizontally (e.g., by changing different product features) to regional requirements (Beath and Katsoulacos 1991: 4–5; Onkvisit and Shaw 2009: 338). Second, the attributes of products could be regionally adapted according to either esthetic (e.g., colors), physical (e.g., norms and standards), functional (e.g., specifications), or symbolic (e.g., design, packaging) dimensions (Emrich 2007: 219–220). Third, services could be regionally adapted along physical good quality (e.g., diversity of services for a product offering), service quality (e.g., reliability), and/or servicescape (e.g., atmosphere) (Keillor et al. 2004: 10–12). Fourth, different degrees of regional product adaptation can be differentiated, ranging from low adaptations for universal products (e.g., language in user manuals), medium adaptations in the case of modified products (e.g., size), to high adaptations for country-specific products (e.g., taste) (Takeuchi and Porter 1986: 133–134; Takeuchi and Porter 1989: 151–152).

A combination of the different forms of regional product/service adaptations with the reasons for regional product/service adaptations (De Búrca et al. 2004: 267–270; Onkvisit and Shaw 2009: 349–359) – as illustrated by Fig. 2.7 – leads to four broad categories: *design*, *functional scope*, *brands*, and *offering portfolio*.

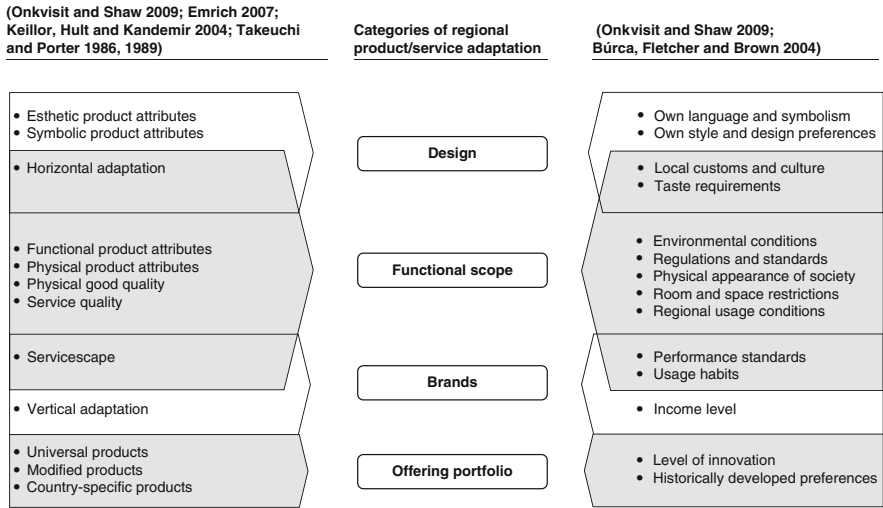
These categories of regional product/service adaptations in Fig. 2.7 illustrate the core customer benefits and characteristics of an *actual* product/service offering – including features, design, packaging, quality level and brand name (Kotler and Armstrong 2004: 279) – which corresponds to the vertical axis of Fig. 2.5 (Rugman 2005b: 48). Their application by academic scholars to describe regional and cross-border product/service adaptations – along *design* (Albaum and Tse 2001: 71; Calantone et al. 2004: 186; Cavusgil et al. 1993: 487–488; Melewar and Saunders 1999: 584;

²⁸As these explanations aim to achieve a schematic understanding of the geographic reach of the FSAs of regional products/services, a MNC's host-regional, multi-regional (or global), and further regional strategies are not explored in more detail. However, it should be noted, that here a likewise argumentation would apply.

Table 2.2 Forms of regional adaptation of products/services

Direction of regional product/ service adaptation (Onkvisit and Shaw 2009)	Adaptation of regional product attributes (Emrich 2007)	Adaptation of regional services (Keillor et al. 2004)	Degrees of regional product adaptation (Takeuchi and Porter 1986, 1989)
• Vertical adaptation – Objective quality of product/service – For example: diamond necklace instead of gemstone • Horizontal adaptation – Different product features – For example: strawberry or chocolate ice cream	• Esthetic product attributes – Different colors – Proportions of products (e.g., North American vs. Asian Barbie doll) • Physical product attributes – Norms and standards (e.g., DIN, ISO) • Functional product attributes – Specifications (e.g., size of beds) • Symbolic product attributes – Design, packaging	• Physical good quality – Quality and diversity of a product offering (e.g., fast-food or grocery services) • Service quality – For example: attention, reliability • Servicescape – Atmosphere – For example: ambient, social environment, design	• Universal products – Low adaptation (e.g., language in user manuals) – Physically the same (e.g., steel, plastics, chemicals) • Modified products – Medium adaptation (e.g., color, size, packaging accessories) – Changes to important attributes (e.g., cars, microwaves) • Country-specific products – High adaptation (e.g., taste) – Consideration of country-specific requirements (e.g., many food products)

Source: own illustration



downstream FSAs, to attract potential customers in foreign markets, MNCs face high risks related to two aspects (Rugman 2005b: 229–230). First, these market-oriented investments are fully one-sided from the part of the MNC, which is compounded by the second aspect, that no customer guarantees to purchase its products/services exist (Rugman 2005b: 229–230). In contrast, investments in upstream FSAs are not completely one-sided, as here all relevant parties (e.g., workers, foreign suppliers, and logistics providers) are themselves engaged in reciprocal commitments to generate value for the jointly established manufacturing or logistics chain apparatus (Rugman 2005b: 229–230). Given that production and delivery cannot be separated in service firms, service MNCs face high location-/region-specific adaptation investments in both upstream and downstream FSAs to achieve regional responsiveness (Rugman 2005b: 233).

Recognizing the explanations above, a *regional product/service* of a MNC ***is the result of the adaptation of downstream and upstream FSAs to regional requirements and conditions in the areas of design, functional scope, offering portfolio, and brands.***

This adaptation of its regional products/services and the previously described, functional activities of its regional management represent changes in a MNC's regional strategy and structure, by which it aims to address requirements imposed by its regional environment (Rugman and Verbeke 2008b: 308). Therefore, the MNC as an organization faces opportunities and constraints in dependence with this external, as well as with its internal, organizational context. In the following we present an important theoretical framework for the conceptualization of these contextual factors that MNCs face at the regional level.

2.3 Contingency Approach

2.3.1 Contingency Theory

Contingency theory aims to develop empirically founded statements about the relationships between external situational conditions, internal organizational structures, the behavior of organizational members, and the achievement of organizational objectives (Gerdin and Greve 2004: 307; Kreikebaum et al. 2002: 22). The theory was developed mainly in the 1960s (Burns and Stalker 1961; Lawrence and Lorsch 1967; Thompson 1967; Woodward 1965) and in the course of the “Aston Programme” that was guided by Derek S. Pugh (Pugh and Hickson 1976) at the University of Aston in Birmingham (UK) (Doz and Prahalad 1991: 151; Kreikebaum et al. 2002: 22). At a more abstract level, the contingency approach suggests that the relationship between an independent variable and a dependent outcome depends, or is contingent, upon a third variable (Donaldson 2001: 5; Drazin and Van de Ven 1985: 514; Gerdin and Greve 2004: 307). In other words: “[. . .] the effect of X on Y when W is low differs from the effect of X on Y when W

is high” (Donaldson 2001: 5–6). In the context of MNCs, the contingency approach – also referred to as the situational approach (Kieser 2006: 215; Kieser and Kubicek 1992: 45–46) – declares organizations as effective if their management realizes a structure and strategy which correspond to the requirements of their environmental and internal situation (Ebers 1981: 6–7). Thus, the organizational effectiveness of a MNC is explained as a function of the *match, or fit, of its strategy and structure with its external and internal contingencies* (Sillince 2005: 608; Venkatraman and Camillus 1984: 513–514; Zeithaml et al. 1988: 44). These external and internal situational characteristics of the MNC are termed *contextual variables* or *contingency variables* (Sousa and Voss 2008: 703). Examples of *internal contingency variables* include products, organizational size, operational technology, the age and development stage of the organization, and the degrees of diversification and internationalization of MNCs (Kreikebaum et al. 2002: 24–25; Roth and Morrison 1992: 484; Schreyögg 2008: 331; Whittington 2006: 814). *External contingency variables* include dynamics and uncertainties in the environment, the intensity of competition, customer demand, a MNC’s customer and supplier structures, and its country culture (Ginsberg and Venkatraman 1985: 427; Hambrick and Lei 1985: 765; Hoque 2004: 488–489; Kreikebaum et al. 2002: 25; Lindsay and Rue 1980: 393; Whittington 2006: 814; Zheng Zhou et al. 2007: 308).

For all possible constellations of these variables, neither a universally optimal organizational structure (Kieser 2006: 215; Zeithaml et al. 1988: 39), nor a universally superior strategy exist (Venkatraman 1989b: 424). Instead, each contextual constellation corresponds to only one efficient organizational structure, which constitutes an organizational equilibrium of the MNC (Kreikebaum et al. 2002: 23). In the case of an organizational disequilibrium, contingency theory assumes a gradual, steady, and continuous adaptation of the organization to its context (Kreikebaum et al. 2002: 23; Meyer et al. 1993: 1177–1178). In contrast to the configuration approach – which assumes that firms are either static or that their organizational change follows quantum jumps between discrete sets of ideal fit types (Doty et al. 1993: 1202; Mintzberg et al. 2007: 352–353, 387) – contingency theory describes a continuous development of MNC organizations over time, along typically linear variable relationships (Donaldson 2001: 122; Schoonhoven 1981: 353). Along those organizational continuums, the contingency approach allows for generalizations of the appropriateness of different strategies to internal or external contextual settings, which is why it is regarded as being well-suited for the research on MNC strategies (Doz and Prahalad 1991: 151; Hambrick and Lei 1985: 765; Hofer 1975: 807).

The formerly described IB theories of Stopford and Wells (1972) and Bartlett and Ghoshal (1989) also draw on the contingency approach (Donaldson 2001: 81–83; Doz and Prahalad 1991: 151; Whittington 2006: 814). While Stopford and Wells (1972: 6) describe organizational change as a function of varying international sales and/or product diversity (Donaldson 2001: 81–82), Bartlett and Ghoshal (2002: 7) view the strategies and organizational designs of MNCs as contingent upon the contextual effects from diverse economic, political, social and technological forces that influence their need for integration and responsiveness (Donaldson

2001: 82–83). Ohmae (1985: 77) also describes successful insiderization strategies as being contingent on the establishment of linkages and relationships with the environment. This demonstrates the commensurability of the theoretical approaches applied in this work, and is reinforced by Rugman's (2005b: 49) regional strategy matrix in Fig. 2.5 – as outlined earlier in Sect. 2.2.1 – which assumes that the simultaneous achievement of regional integration and regional responsiveness by a MNC is contingent upon its particular regional environment-strategy-structure relationship. This relationship is affected by the MNC's geographic reach of location-/ region-bound and non-location-bound FSAs, and by its CSAs, which are particularly influenced by two contingency variables: regional orientation and inter-regional distance. After the following critical review of the contingency approach, we will present them in more detail.

A critical assessment of contingency theory is comprised of four facets along methodological and conceptual issues. The first criticism regards its limited explanatory power – as empirical results are only meaningful if the variables under research are independent of each other, which rejects the more realistic interdependencies between the influencing variables of an organization's structure and efficiency (Kreikebaum et al. 2002: 25). Second, the contingency approach has been criticized for the lack of clarity and precision in its theoretical concepts, interactions, and underlying assumptions (Kieser and Kubicek 1992: 220, 412; Schoonhoven 1981: 349–354; Schreyögg 2008: 355). Third, criticisms are directed towards the missing dynamics in its variable relationships and the encouragement of dichotomous thinking (Doz and Prahalad 1991: 151; Kieser 2006: 233–237; Kreikebaum et al. 2002: 25). Fourth, a generalization of the statements of contingency theory is not possible due to the shortcomings in the comparability, validity, and reliability of its applied measures (Kieser 2006: 231–232; Kreikebaum et al. 2002: 25).

Recognizing these problems, we agree with Schoonhoven (1981: 349), that the application of contingency theory requires precise hypotheses on the expected empirical relationships, which this work aims to achieve. Besides this, we do not assume a strong determinism between an organization's context and its structure and/or strategy (Kreikebaum et al. 2002: 25). Rather we take a *moderate voluntaristic* perspective for a MNC's achievement of appropriate degrees of managerial decision-making autonomy and regional product/service adaptation (Gilbert 2005: 410–411; Kreikebaum et al. 2002: 171).²⁹ This application of contingency theory highly recognizes that there is neither one universal “best way” for realizing regional strategies, nor that their achievement is solely situation-specific (Hambrick and Lei 1985: 765; Zheng Zhou et al. 2007: 305).

²⁹According to this perspective, the external and internal organizational context influence the managerial decision-making autonomy and regional product/service adaptation of MNCs – yet, at the same time, a firm can intervene in the processes related to the realization of its regional strategy – thus the relationship between regional strategy and its result can be described as emergent (Gilbert 2005: 411; von Hayek 1969).

2.3.2 Contingency Variables

2.3.2.1 Regional Orientation

The regional orientation is a form of geographic orientation of MNCs, in contrast to a local or global orientation (Banalieva and Santoro 2009: 344–345). It relates to the focus of senior management in the geographic expansion of MNCs (Delios and Beamish 2005: 20; Rugman 2005b: 202). It reflects a firm-internal, regiocentric orientation of MNC managers, who mainly view the region as a potential market (Proff 2002: 242, 245; Wind et al. 1973: 15),³⁰ resulting in a narrow geographic **market** focus (Rugman 2005b: 212, 231; Rugman and Verbeke 2008b: 312) and a selectivity in the geographic scope of **activities** (Rugman 2005b: 77, 212; Rugman and Verbeke 2004: 16). The distribution of sales and assets of MNCs among economic regions indicates the type of a **market-related**, or respectively, an **activity-related regional orientation**, each ranging from home-regional, host-regional, bi-regional, to multi-regional (global) (Goerzen and Asmussen 2007: 66–67; Oh 2009: 342; Rugman 2005b: 4; Rugman and Verbeke 2004: 5, 7). Therefore a MNC's high orientation towards, or focus on, a particular region results from a low geographic distribution of its sales and assets. Consequently, the strongest form of regional orientation is a focus on the home region, indicating the lowest possible geographic dispersion of markets and activities. Thus, a MNC's regional orientation decreases from home-regional to host-regional, from host-regional to bi-regional, and from bi-regional to multi-regional (global) – illustrating different extents of its regional multinationality (Contractor 2007b: 16; Verbeke et al. 2009: 150). The regional orientation of MNCs following further regional strategies – i.e., directive-regional, adaptive-regional, cooperative-regional, and trans-regional (world mandate) strategies – also depends on their particular geographic focus. These varying degrees of regional orientation are based on the geographic spread of markets and activities, which depends upon a MNC's geographic reach and scope.

We believe that the regional orientation of a MNC is an important **internal contingency variable** in the relationship between a MNC's regional strategy and/or structure components and the achievement of its corporate goals and objectives. This is supported by Rugman (2005b: 212) who states that a strong regional orientation, given by a narrow geographic market and product/service focus: “[...] will help to develop the FSAs capable of providing maximum value added to customers”. For example, in the case of a home-regional orientation, the capitalization on such customer-end opportunities relates to an organizational and strategic efficiency, as no additional, one-sided, location-specific investments in other regions are needed (Rugman 2005b: 231). Therefore a MNC's regional orientation – as the selection of a particular geographic focus – should be an important internal

³⁰This may relate to attitudinal characteristics of MNCs (Sullivan 1994: 331), regarding their: “[...] orientation toward ‘foreign people, ideas, resources’, in headquarters and subsidiaries, and in host and home environments [...]” (Perlmutter 1969: 11).

contextual variable for MNCs that influences the probability of achieving their corporate goals and objectives (Rugman and Verbeke 2008b: 312).

2.3.2.2 Inter-regional Distance

MNCs doing business in new markets face costs and risks from barriers created by distance (Ghemawat 2001: 138). This distance can either be intra-regional within a particular region (Verbeke 2009: 453), or inter-regional between two or more regions. According to Rugman (2005b: 77), MNCs have to consider the costs and risks of *inter-regional distance* in the economic evaluation of their international growth plans. Inter-regional distance is comprised of *cultural, administrative/political/institutional, geographic*, and *economic dimensions* (Ghemawat 2001: 140; Ghemawat 2008: 34; Ricart et al. 2004: 181; Rugman 2005b: 230), as illustrated in the so-called “CAGE framework” (Ghemawat 2001: 140; Ghemawat 2008: 41; Ricart et al. 2004: 181) in Table 2.3.³¹

Inter-regional cultural distance refers to differences in the cultural attributes between the home country/region and host regions, which determine the interactions among people (Ghemawat 2001: 140; Ghemawat 2008: 40; Rugman 2005b: 223).³² These inter-regional cultural differences can sometimes be easily perceived (e.g., language), but they can also be nearly invisible (e.g., social norms) (Ghemawat 2008: 42). From one region to another, they cause differing, culture-specific demands on MNCs (Gilbert 1998: 66), such as color preferences of consumers in their choices between substitute products/services (Ghemawat 2001: 142).

Inter-regional administrative, political, or institutional distance relates to differences in laws, policies, and institutions across regions, which affect cross-border economic activity (Ghemawat 2008: 42–43). These inter-regional differences may result, for example, from a lack of colonial ties between the home country/region and host region, from different currencies, or from not belonging to the same regional trading bloc (e.g., EU versus NAFTA membership) (Ghemawat 2001: 142–143; Ghemawat 2008: 43). Furthermore, the characteristics of a particular region (e.g., governmental policies, weak institutional infrastructure conditions) might impede MNCs from entering this region during their cross-border expansion (Ghemawat 2001: 144).

³¹Inter-regional distance refers to bilateral differences between two particular regions, as well as to unilateral/multilateral differences between the home region and two or more other regions (Ghemawat 2008: 39).

³²Following Rugman (2005b: 223), we mainly focus on cultural differences at the regional level. This does not include the different levels of corporate culture differences within a particular MNC (Gilbert 1998: 67; Schein 1995: 30). Instead this subsumes country culture influences (Hofstede 1983: 75; Hofstede 1993: 22–23, 206–207) and more aggregate, regional cultural effects. However, it should be noted, that this represents a conceptual simplification, as a considerable cultural heterogeneity may prevail within both regions and countries (Gilbert 1998: 67; Hofstede 1997: 7–11; Macharzina et al. 1998: 160).

Table 2.3 Dimensions of inter-regional distance

Inter-regional distance			
Cultural distance	Administrative/political/ institutional distance	Geographic distance	Economic distance
• Different languages • Different ethnicities; lack of connective ethnic or social networks • Different religions • Level of trust • Different values, social norms, and dispositions	• Lack of colonial ties • Lack of shared regional trading bloc (monetary or political association) • Lack of common currency • Political hostility • Government policies • Institutional weakness	• Physical distance, remoteness • Lack of a common (land) border • Lack of sea or river access • Size of country/region • Weak transportation or communication links • Differences in time zones • Differences in climates and disease environments	• Differences in consumer incomes (rich-poor differences) • Other differences in costs and quality of – Natural resources – Financial resources – Human resources – Infrastructure – Intermediate inputs – Information or knowledge

Source: own illustration on the basis of Ghemawat (2001: 140), Ghemawat (2008: 40), and Ricart et al. (2004: 181)

In addition to the physical distance between regions, *inter-regional geographic distance* includes the presence or absence of a common (land) border, access to waterways and the ocean, size of the country, weak transportation or communication links, and different time zones and climates (Ghemawat 2001: 144–145; Ghemawat 2008: 44). These various aspects of geographic distance influence transportation and communication costs of MNCs (Ghemawat 2008: 44), which may explain reductions in inward FDI of a particular region (Feils and Rahman 2008: 160).

Inter-regional economic distance results from differences in the wealth or income of consumers, and from any other variations in the cost and quality of resources, inputs, infrastructure and information (Ghemawat 2001: 145; Ghemawat 2008: 45). Macroeconomic effects from differences in consumer incomes can be observed in a higher cross-border economic activity of regions with many rich countries than of those regions with more poor countries (Ghemawat 2001: 145). At the microeconomic level, regional differences in per-capita incomes affect the labor costs of a MNC, while regional differences in skill levels may influence the quality of its products/services (Ghemawat 2008: 45).

The inter-regional distance faced by a particular MNC may result in a competitive disadvantage from its *liability of foreignness* in the form of additional costs of doing business abroad (Ellis 2007: 377; Ghemawat 2008: 56; Hymer 1976: 34–36; Kindleberger 1969: 11–14; Rugman 2005b: 229; Rugman and Verbeke 2007: 201; Rugman and Verbeke 2008c: 331; Zaheer 1995: 342–343; Zaheer 2002: 351–352). Inter-regional distance, therefore, is an important *external contingency variable* in the achievement of a MNC's corporate goals and objectives – particularly regarding adaptation, aggregation, and arbitrage benefits from regional strategy-structure combinations (Arregle et al. 2009: 88–92; Buckley and Ghauri 2004: 87; Rugman 2005b: 76). For example, the adaptation of a MNC's products/services to a foreign host region requires higher investments to link its existing FSAs with foreign CSAs, if the inter-regional distance is high (Ghemawat 2008: 110–113; Rugman 2005b: 225). Aggregation economies of scale or scope are also contingent upon inter-regional distance, as they are easier to achieve, for example if the MNC can benefit from a higher economic integration or institutional proximity between regions (Arregle et al. 2009: 89; Ghemawat 2008: 158–159). A lower inter-regional distance facilitates earning arbitrage benefits for MNCs, as they may, for example, more flexibly relocate their foreign investments to exploit differences across regions (Arregle et al. 2009: 91; Ghemawat 2008: 174–180; Rugman 2005b: 76; Rugman and Verbeke 2004: 16). Furthermore, inter-regional cultural, economic and physical differences require regional decision-making by MNCs, to be responsive to their customers (Enright 2005b: 84; Yeung et al. 2001: 169). Consequently, the organizational and strategic effectiveness and overall competitiveness of MNCs is highly externally contingent upon the inter-regional distance they face (Ghemawat 2001: 147; Ghemawat 2008: 228; McLarney and Dastrala 2001: 349, 366; Rugman and Verbeke 2004: 5).

Organizational and strategic effectiveness are usually measured by the corporate success of MNCs, for example by their return on investment, profit, or other

performance variables (Donaldson 2001: 10; Venkatraman and Ramanujam 1986: 803; Zeithaml et al. 1988: 49). A MNC's effectiveness at the regional level depends on different factors – like its particular regional product/service offering, regional management configuration, and contingency variables – and is measured by its regional corporate success that we will present next.

2.4 Concept of Regional Corporate Success

2.4.1 *Success Factor Theory*

Success factor research aims to identify the determinants that influence the long-term success of a MNC, where those measures that quantify the long-term success of a MNC are called *success indicators* – while those variables influencing these success indicators are termed *success factors* (Fritz 2004b: 24–25; Haenecke and Forsmann 2006: 45).

The origins of success factor research date back to 1961, when the McKinsey consultant D. Ronald Daniel advocated a concept of success factors to improve internal management information systems (Daniel 1961: 116; Nicolai and Kieser 2002: 580). Around this time, the PIMS (Profit Impact of Marketing Strategies) program was developed, which systematically gathers firm data since the 1960s of more than 300 companies with approximately 3,000 strategic business units (SBUs) (Haenecke and Forsmann 2006: 45; Kreikebaum 1997: 113–117). While some of the following approaches such as Rockart's (1979: 86) concept of critical success factors tried to identify such factors on the basis of extensive, case-by-case interviews of particular companies (Trommsdorff 1990: 2–3), other researchers tried to derive success factors for whole industries or even across all types of companies (Nicolai and Kieser 2002: 580).

Since its very beginning in the 1960s, success factor research has been criticized either for not being *relevant* enough to practitioners, or for not being sufficiently *rigorous* according to theoretical quality requirements (Gulati 2007: 776; Kieser and Nicolai 2003: 592).³³ For success factor studies, this persisting trade-off between rigor and relevance (Kieser and Nicolai 2003: 591; Kieser and Nicolai 2005: 275) causes the: “[...] problem of bridging the gap between the social system that produces scientific knowledge [...] and the social system where professional practice takes place [...]” (Simon 1967: 16). Some argue, based on Luhmann (1986, 1998, 2005), that this gap will remain, as science and practice are self-referential (autopoietic) social systems that face major differences between each other (Kieser and Leiner 2009: 518–519; Kieser and Nicolai 2003: 591; Kieser and Nicolai 2005: 276; Nicolai and Kieser 2002: 592). Others argue that

³³From the 1960s onwards, the trend was first towards more relevance, while since the 1980s a development towards more rigor was observed (Gulati 2007: 776).

Table 2.4 Requirements of “good” success factor research

“High” rigor	“High” relevance
Application of adequate theories	Research based on practical issues
Theory development based on different perspectives	Translation function of researchers
Theoretically grounded, causal relationships	Consideration of the organizational context
Methodological rigor	Representative research sample

Source: own illustration

this rigor-relevance gap can be bridged by theoretically grounded, problem-oriented research (Bettis 1991: 317; Gulati 2007: 775; Luther 1998: 704; Schendel 1995: 1), thus by: “[. . .] work that is rigorous both theoretically and methodologically *and* centered on issues of focal concern to a wide community of stakeholders (e.g. managers, government policy makers, trades unionists, and consumer groups) [. . .]” (Hodgkinson et al. 2001: S46).

In this work, we accept the existence of a gap between theory and practice (Kieser and Nicolai 2003: 592), in the sense that insights from success factor studies cannot be used instrumentally (Ghemawat 1991: 11; Kieser and Nicolai 2005: 278; Nicolai and Kieser 2002: 584), like an immediate prescription or advice for exercising certain managerial actions that will increase corporate profits by X percent (Vermeulen 2007: 754). However, we agree with Fincham and Clark (2009: 514) that management studies as a social science is less of a closed system than natural science, for example. Therefore we assume that crossing this gap is possible, particularly by a certain level of practical relevance (Kieser 2004: 3), one that enables critical reflections on current practices (Kieser and Leiner 2009: 528).³⁴ Such an approach offers alternatives to real-world issues, it questions preferred argumentation patterns of practice and points to relationships that have been neglected in practice so far (Kieser and Nicolai 2003: 592; Kieser and Nicolai 2005: 278; Rasche and Behnam 2009: 252).

The previous arguments indicate that success factor theory has a small core (Bauer and Sauer 2004: 623); one that refers to “*good*” *success factor research*, a combination of “*high*” *rigor* – concerning the specification and the theoretical foundation of research models, data inquiry and data analysis (Homburg and Krohmer 2004: 630) – and “*high*” *relevance* for the reflection of real-world issues. Therefore in the following and as illustrated in Table 2.4, we formulate requirements for our work of “good” success factor research, based on the recommendations of academic scholars and researchers (Markides 2007: 766) related to both “high” rigor and “high” relevance.

With respect to “*high*” *rigor*, Ghoshal (2005: 86) argues that: “[. . .] nothing is as dangerous as a bad theory”, meaning that a theory can only reveal true insight if it

³⁴This is in line with the argumentation of Markides (2007: 766) who claims for a higher differentiation of the different types of managerially relevant research, where one might be the development of grand new theories without any empirical evidence, and another the development of new theoretical rationales for current business phenomena.

has reality in mind (Tushman and O'Reilly 2007: 769, 772; Vermeulen 2007: 755). Examples of such *adequate theories* to explain real-world issues include Porter's (1985) influential work on strategy or Hofstede's (1983) study of cultural influences on values in the workplace (Starkey et al. 2009: 553).³⁵ Therefore *theory development should be based on different perspectives* – e.g., implying a regular, intensive dialogue and interaction with practitioners (Markides 2007: 762; Rynes 2007: 745; Starkey et al. 2009: 551; Tushman and O'Reilly 2007: 769; Vermeulen 2007: 757; Worrell 2009: 129), to get to the heart of practical matters (Gulati 2007: 780; Rynes 2007: 746). Even though researchers should trade some rigor for more relevance (Gulati 2007: 777; Starkey et al. 2009: 550), the ideas of researchers about *causal relationships* should still be *grounded in existing or new theory* (Gulati 2007: 780) and/or should *integrate different theories* (McGahan 2007: 750).³⁶ Furthermore, *methodological rigor* should ensure the proper operationalization of variables and the utilization of appropriate statistical methods (Fritz 2004a: 625; Nicolai and Kieser 2002: 584).³⁷ Methodologically sound research should properly address the key informant bias (Fritz 2004b: 26–30; Haenecke and Forsmann 2006: 50; Hurrle and Kieser 2005: 598; Kieser 2004: 3–9; Nicolai and Kieser 2002: 584; Nicolai and Kieser 2004: 633), as well as problems from endogeneity (influences of non-collected variables on independent variables), simultaneity (effects from prior success on managerial actions), unobserved heterogeneity (differences in the long-term success potential of firms), regression-to-the-mean (effects from randomly occurring successes and failures of firms), and the survival bias (research focusing solely on firms that have survived) (Nicolai and Kieser 2002: 584–585).

“High” relevance relates to generating insights for practitioners to better understand their own organizations and situations (Markides 2007: 764–765; Vermeulen 2007: 755). Therefore, practitioners are viewed as stakeholders, the central audience of research, to realize a *research based on practical issues* that addresses important managerially relevant topics and problems (Bennis and O'Toole 2005: 103; Markides 2007: 763–764). Here, researchers have a *translation function* in the communication between science and practice (Gulati 2007: 780–781; Hodgkinson and Rousseau 2009: 543; McGahan 2007: 748; Vermeulen 2007: 759). More specifically, they should establish a common frame of reference (Kieser and Nicolai 2005: 276) that ensures speaking the same language, and that communicates

³⁵For further examples cf. Hodgkinson and Rousseau (2009: 539–541).

³⁶Here it should be noted that – as researchers can only derive knowledge from falsifying hypotheses about causal relationships, instead of measuring them directly – success factor research can only shed light on possible reasons of success (Haenecke and Forsmann 2006: 48).

³⁷In the operationalization of variables, no average values across firms should be utilized, as success is firm-specific and unique (Nicolai and Kieser 2002: 585–586). Furthermore it should be considered that one success indicator cannot adequately address the diversity of the real-world success (Nicolai and Kieser 2002: 586–587), and that success factor research is always based on past data, which limits the transferability of its findings to the future (Nicolai and Kieser 2002: 587).

meaning by the transfer of schemas between the two contexts (Hodgkinson and Rousseau 2009: 537–538; Kieser and Leiner 2009: 528; Starkey et al. 2009: 556).³⁸ In addition, not necessarily by introducing many control variables (Kieser and Nicolai 2005: 276–277; Nicolai and Kieser 2002: 582),³⁹ the *organizational context* should be considered (Eggert et al. 2005: 103; Starkey et al. 2009: 556), as more informed theory building can be achieved by research that is well-grounded in organizational contexts (Hodgkinson and Rousseau 2009: 542). To achieve relevance, some claim for large-scale empirical analyses (McGahan 2007: 749), while others question the usefulness of existing big research projects and meta-analyses (Fritz 2004a: 624; Homburg and Krohmer 2004: 627; Nicolai and Kieser 2002: 582–584; Nicolai and Kieser 2004: 632). Therefore, rather than solely size, the quality reflected in a *representative research sample* (Nicolai and Kieser 2002: 584) seems to be more important for practical relevance.

By applying the requirements of “good” success factor research in our work, we aim to realize academic rigor in the sense of Kieser and Nicolai (2005: 278), one that achieves practical relevance by enhancing the dialogue about alternatives to existing practices of MNCs in their regional strategies, either regarding their regional product/service adaptation or their regional management autonomy.

2.4.2 Regional Corporate Success

The establishment of a solid theoretical and practical basis in this dialogue requires a concept of regional corporate success that recognizes both the requirements of academic rigor and practical relevance. To achieve such a “good” success factor research, we aim to focus on five facets of regional corporate success.

First, regarding practical relevance, the generation of regional success indicators should be based on the *external regional financial reporting* of the Fortune Global 500 firms, as this leads to a common frame of reference in the translation between our research and the language and terminology used by practitioners. A synthesis of the requirements from accounting standards for geographical segment reporting (Behn et al. 2002: 33; Epstein and Jermakowicz 2009: 50; Langguth 2006: 629; Lee et al. 2008: 54; Prather-Kinsey and Meek 2004: 215; Schween 2006: 517) and an analysis of the annual reports of the Fortune Global 500 firms – for the period

³⁸This form of dialogue still regards science and practice as separated social systems, as it does not assume the rather uncommon case of collaborative research projects of scientists and researchers to jointly produce research results (Kieser and Leiner 2009: 529; Rasche 2007: 297).

³⁹Kieser and Nicolai (Kieser and Nicolai 2005: 277; Nicolai and Kieser 2002: 582) argue that the introduction of more and more control variables leads to a reduced clarity of the simple causal relationship which was originally identified by research.

2000–2008 – leads to five main categories in their external regional financial reporting: *sales revenues*, *profits*, *investments*, *assets*, and *employees*.⁴⁰ Therefore, this regional information reported by the Fortune Global 500 firms will serve as guidance in generating regional success indicators.

Second – with respect to the methodological rigor of this work – we want to analyze the *development* of regional corporate success indicators *over time* – to properly analyze the problems of simultaneity, unobserved heterogeneity, regression-to-the-mean, and of the survival bias (Nicolai and Kieser 2002: 584–585). This will be achieved by studying various success indicators of the Fortune Global 500 firms in a *longitudinal study* over nine financial reporting periods from 2000 to 2008. Here, based on the financial reporting information mentioned above, we aim to investigate *absolute* (e.g., regional sales revenue, regional profit, regional assets), *relative* (e.g., regional sales to total sales, regional profit to total profit, regional assets to total assets, regional sales per regional employee, regional profit per regional employee), and *dynamic regional success indicators* (e.g., sales growth, profit growth) of MNCs over time. These are very commonly utilized success indicators in success factor studies (Nicolai and Kieser 2002: 581). Such a study of regional performance over long time frames with large samples is highly encouraged (Glaum and Oesterle 2007: 315; Hult et al. 2008a: 1073; Seno-Alday 2009: 376).

Third – as no consensus exists on which indicator appropriately constitutes firm performance (Nicolai and Kieser 2002: 586–587) – in our modeling of regional corporate success,⁴¹ we aim to define *regional corporate success as a construct of various indicators*. Here, following academic rigor, we apply adequate theories – particularly the dominant conceptual work on regional strategies (e.g., Rugman 2005b; Rugman and Verbeke 2008b) – to identify the most important indicators of regional corporate success.

Fourth, regarding these most important regional corporate success indicators, the *differences* between their *objective presentation* by means of financial reporting information and its *subjective estimations* by MNC managers should be analyzed (Chen 1999: 161; Dawes 1999: 71; Dess and Robinson 1984: 270; Fritz 2004b: 29; Geringer and Hebert 1991: 256; Hult et al. 2008a: 1070–1071; Schmidt 2004: 151). Using the analysis of these differences, we aim to ensure that meaning is communicated between our research and its theoretical and practical implications by the transfer of schemas between the two contexts – which represents an important condition to bridge the gap between rigor and relevance (Hodgkinson and Rousseau 2009: 537–538; Kieser and Leiner 2009: 528; Starkey et al. 2009: 556).

Fifth, following the moderate voluntaristic approach of this work, firm-specific regional corporate success indicators are understood as being contingent upon the internal and external organizational context of MNCs. Consequently, regional

⁴⁰This wording excellently represents the different terminology applied by the Fortune Global 500 firms in their geographical segment reporting, as illustrated in Table A2. Cf. Sects. 5.1.2 and 6.1.

⁴¹Cf. Sect. 4.1.4.

corporate success is regarded as the result of a “fit” of appropriate degrees of *firm-specific* regional management autonomy (as regards managerial decisions) and regional product/service adaptation (as regards product attributes/service elements) with interaction effects from the *internal* regional orientation of the MNC and its *external* inter-regional distance.

To capture and to properly examine these influences in the relationship between regional strategies and regional corporate success, in the following – based on methodological and conceptual grounds – we will develop a regional success factor model.

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