

International Business 7e

by Charles W.L. Hill

Chapter 13

The Organization of International Business

Introduction

❖ **Organizational architecture** refers to the totality of a firm's organization, including formal organization structure, control systems and incentives, processes, organizational culture, and people

To be the most profitable, firms need to be sure:

- ❖ the different elements of the organizational architecture are internally consistent
- ❖ the organizational architecture matches or fits the strategy of the firm
- ❖ the strategy and architecture of the firm are consistent with each other, and consistent with competitive conditions

Organizational Architecture

Organizational structure refers to:

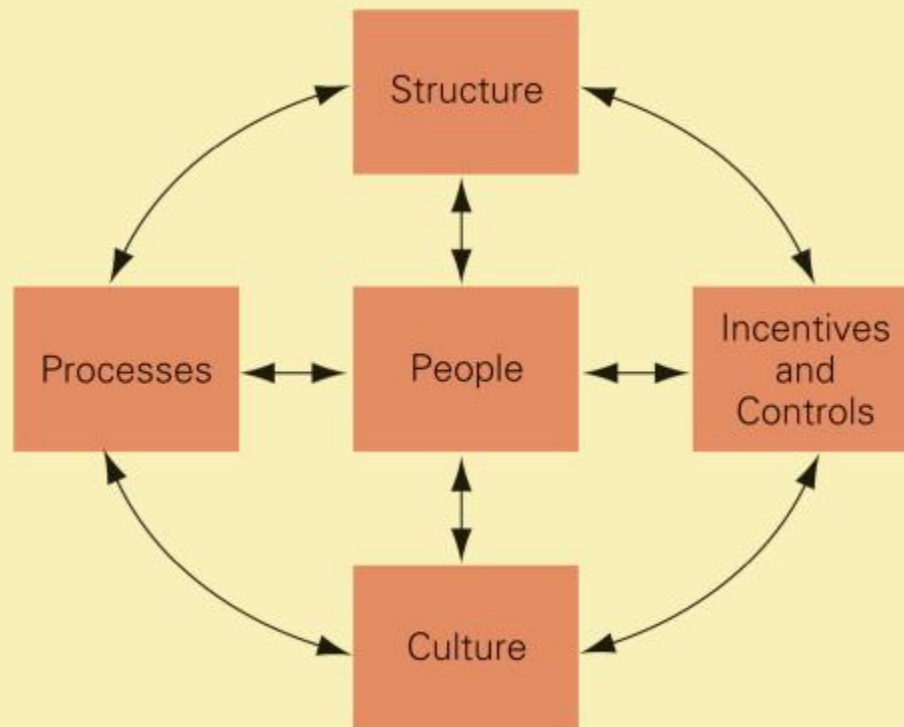
- ❖ the formal division of the organization into subunits
- ❖ the location of decision-making responsibilities within that structure (centralized versus decentralized)
- ❖ the establishment of integrating mechanisms to coordinate the activities of subunits including cross-functional teams or pan-regional committees
- ❖ **Control systems** are the metrics used to measure performance of subunits and make judgments about how well managers are running those subunits

Organizational Architecture

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

Organizational Architecture

Figure 13.1: Organizational Architecture



Classroom Performance System

The norms and value systems that are shared among the employees of an organization are called

- a) processes
- b) organizational culture
- c) control systems
- d) incentives

Organizational Structure

- ❖ Organizational structure has three dimensions:
 1. **Vertical differentiation** - the location of decision-making responsibilities within a structure
 2. **Horizontal differentiation** - the formal division of the organization into sub-units
 3. The establishment of **integrating mechanisms** - the mechanisms for coordinating sub-units

Vertical Differentiation: Centralization And Decentralization

- ❖ Vertical differentiation determines where decision-making power is concentrated

Centralized decision-making:

- ❖ facilitates coordination
- ❖ ensure decisions consistent with organization's objectives
- ❖ gives top-level managers the means to bring about organizational change
- ❖ avoids duplication of activities

Vertical Differentiation: Centralization And Decentralization

Decentralized decision-making:

- ❖ relieves the burden of centralized decision-making
 - ❖ has been shown to motivate individuals
 - ❖ permits greater flexibility
 - ❖ can result in better decisions
 - ❖ can increase control
-
- ❖ It can be worthwhile to centralize some decisions and decentralize others

Classroom Performance System

Which of the following is *not* an advantage of centralized decision-making?

- a) It facilitates coordination
- b) It motivates employees
- c) It gives top-level managers the means to bring about organizational change
- d) It avoids duplication of activities

Horizontal Differentiation: The Design Of Structure

❖ Horizontal differentiation is concerned with how the firm decides to divide itself into sub-units

The decision is usually based on:

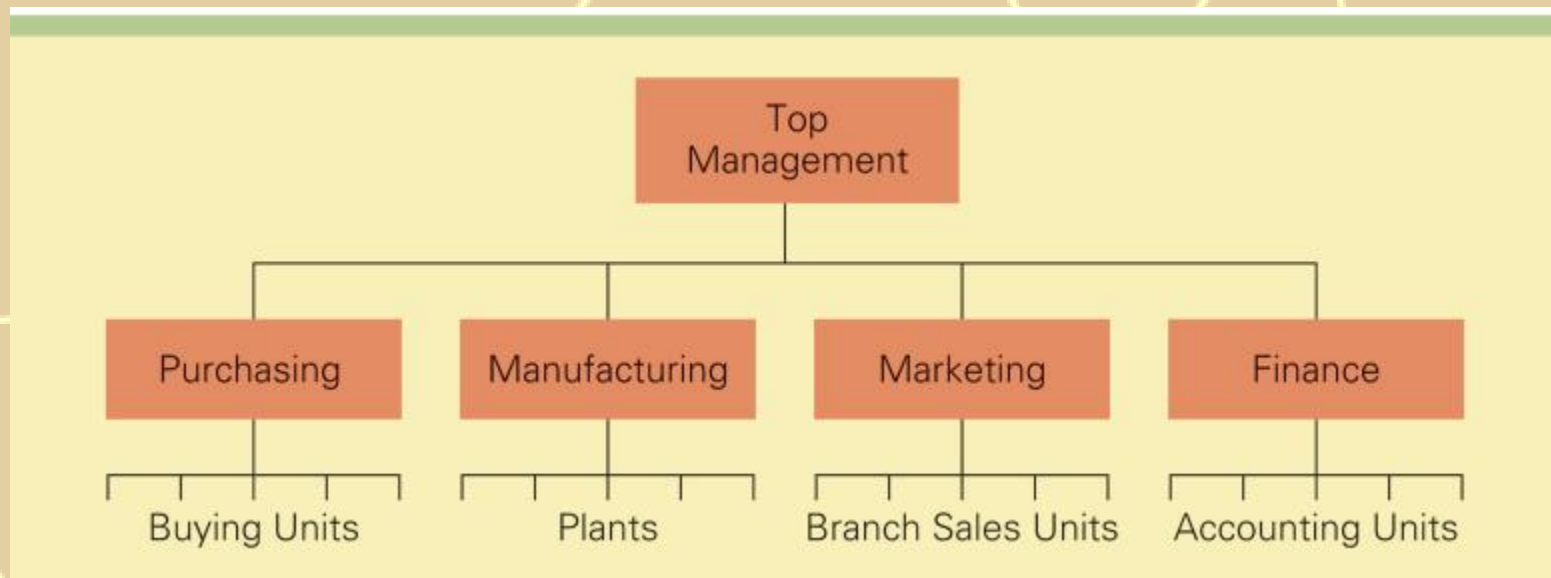
- ❖ function
- ❖ type of business
- ❖ geographical area

Horizontal Differentiation: The Design Of Structure

- ❖ Most firms begin with no formal structure
- ❖ As they grow, the organization is split into functions reflecting the firm's value creation activities (functional structure)
- ❖ The functions are typically coordinated and controlled by top management
- ❖ Decision-making tends to be centralized
- ❖ If the firm diversifies its product line, further horizontal differentiation may be necessary
- ❖ Firms may switch to a product divisional structure where each division is responsible for a distinct product line

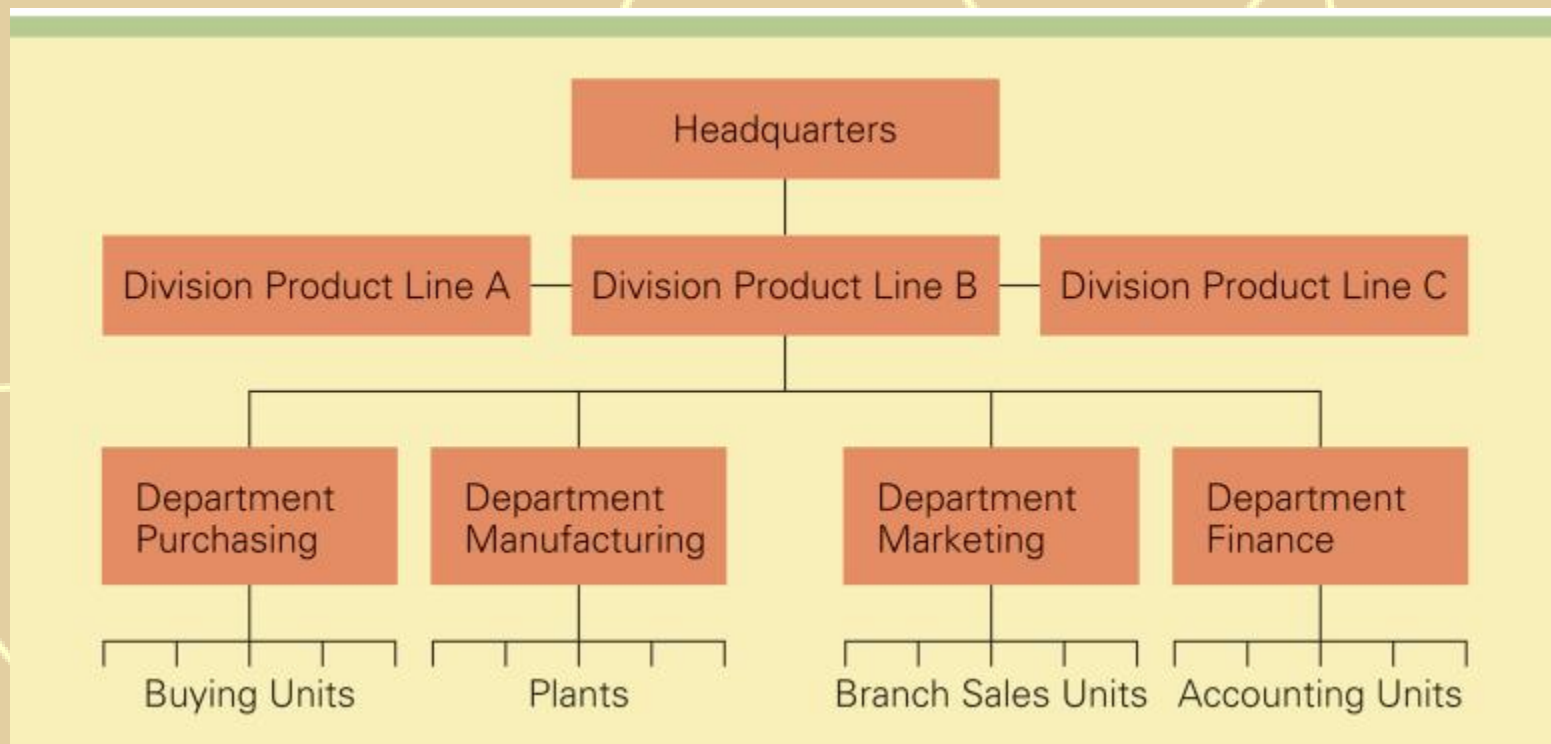
Horizontal Differentiation: The Design Of Structure

Figure 13.2: A Typical Functional Structure



Horizontal Differentiation: The Design Of Structure

Figure 13.3: A Typical Product Divisional Structure

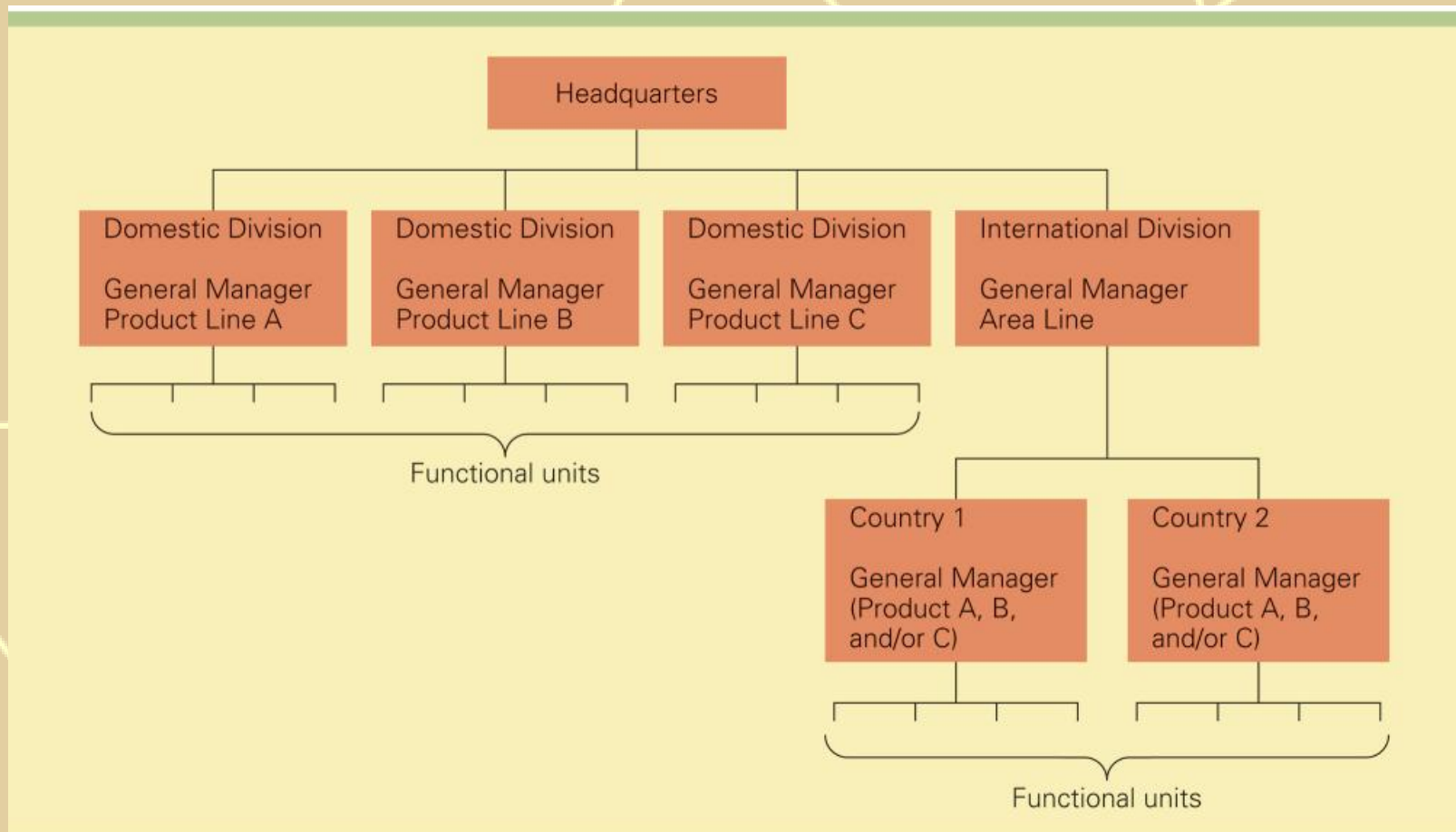


Horizontal Differentiation: The Design Of Structure

- ❖ When firms expand internationally, they often group all of their international activities into an **international division**
- ❖ In time it might prove viable to manufacture the product in each country
- ❖ The result could be that firms with a functional structure at home would replicate the functional structure in every country in which they do business and firms with a divisional structure would replicate the divisional structure in every country in which they do business
- ❖ This creates the potential for conflict and coordination problems between domestic and foreign operations

Horizontal Differentiation: The Design Of Structure

Figure 13.4: One Company's International Divisional Structure



Horizontal Differentiation: The Design Of Structure

Many firms that continue to expand will abandon their international division structure and move to either a:

- ❖ **Worldwide product divisional structure** - tends to be adopted by diversified firms that have domestic product division
- ❖ **Worldwide area structure** - tends to be adopted by undiversified firms whose domestic structures are based on functions

Horizontal Differentiation: The Design Of Structure

Figure 13.5: The International Structural Stages Model



Horizontal Differentiation: The Design Of Structure

The worldwide area structure:

- ❖ is favored by firms with low degree of diversification and a domestic structure based on function
- ❖ divides the world into autonomous geographic areas
- ❖ decentralizes operational authority
- ❖ facilitates local responsiveness
- ❖ can result in a fragmentation of the organization
- ❖ is consistent with a localization strategy

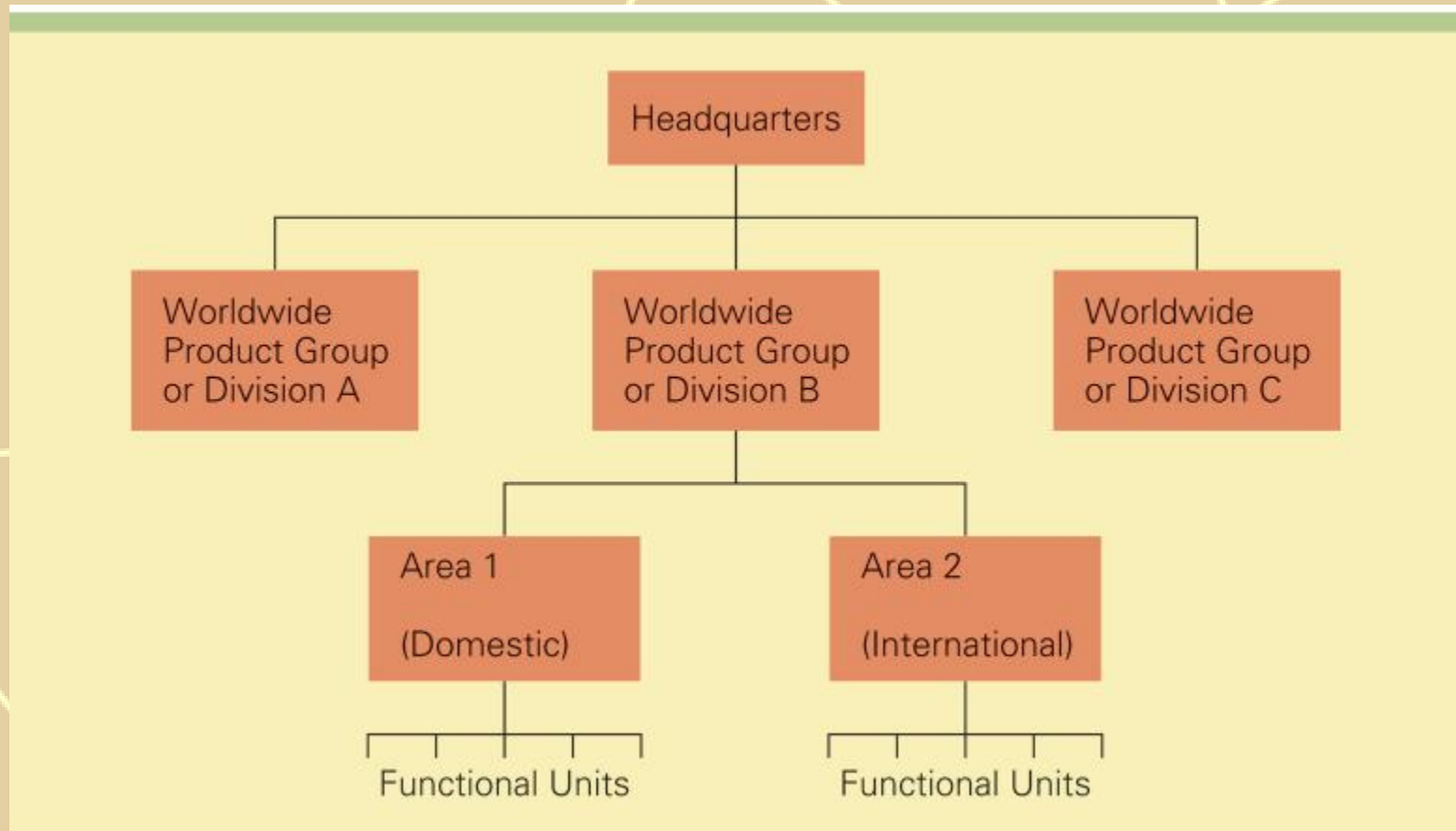
Horizontal Differentiation: The Design Of Structure

The worldwide product division structure:

- ❖ is adopted by firms that are reasonably diversified
- ❖ allows for worldwide coordination of value creation activities of each product division
- ❖ helps realize location and experience curve economies
- ❖ facilitates the transfer of core competencies
- ❖ does not allow for local responsiveness

Horizontal Differentiation: The Design Of Structure

Figure 13.6: A Worldwide Product Divisional Structure



Horizontal Differentiation: The Design Of Structure

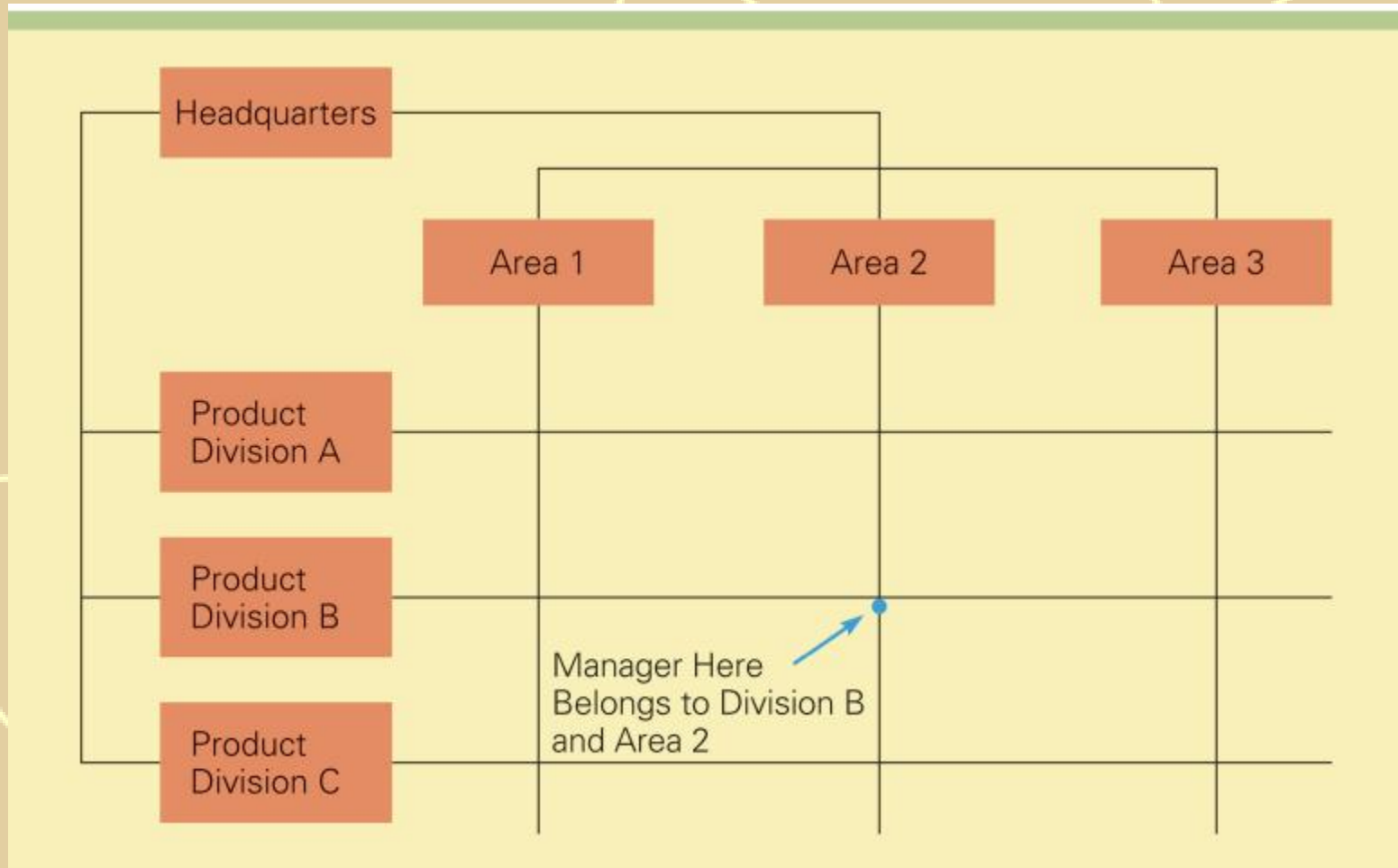
❖ The **global matrix structure** is an attempt to minimize the limitations of the worldwide area structure and the worldwide product divisional structure

The global matrix structure:

- ❖ allows for differentiation along two dimensions - product division and geographic area
- ❖ has dual decision-making - product division and geographic area have equal responsibility for operating decisions
- ❖ can be bureaucratic and slow
- ❖ can result in conflict between areas and product divisions
- ❖ can result in finger-pointing between divisions when something goes wrong

Horizontal Differentiation: The Design Of Structure

Figure 13.7: A Global Matrix Structure



Classroom Performance System

Most firms begin their international expansion with a(n) _____ structure.

- a) Matrix
- b) Worldwide product division
- c) Worldwide area division
- d) International division

Classroom Performance System

Which type of organization structure has a dual decision-making system?

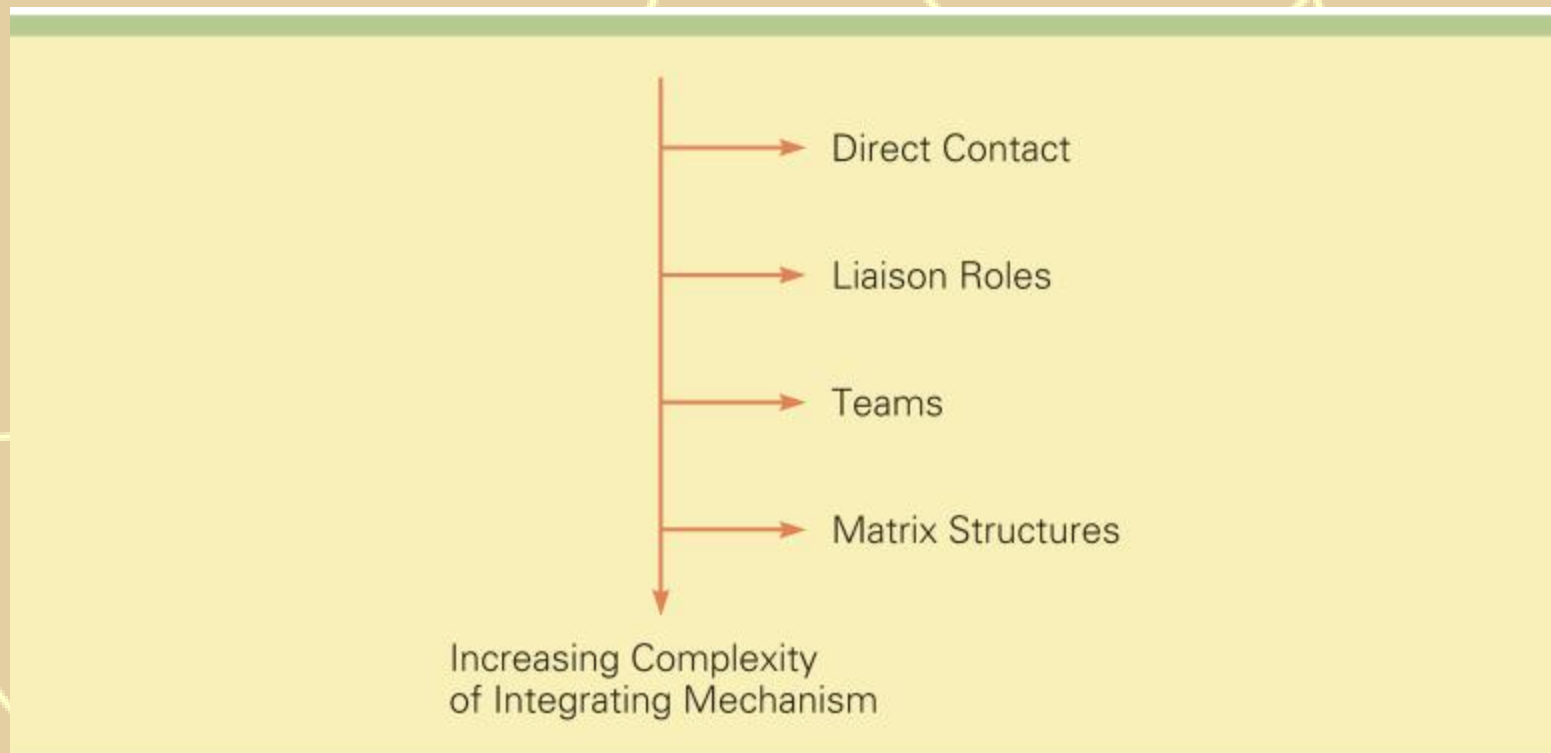
- a) Matrix
- b) Worldwide product division
- c) Worldwide area division
- d) International division

Integrating Mechanisms

- ❖ Regardless of the type of structure, firms need a mechanism to integrate subunits
- ❖ The need for coordination is lowest in firms with a localization strategy and highest in transnational firms
- ❖ Coordination can be complicated by differences in subunit orientation and goals
- ❖ The simplest formal integrating mechanism is direct contact between subunit managers, followed by liaisons
- ❖ Temporary or permanent teams composed of individuals from each subunit is the next level of formal integration
- ❖ Finally, the matrix structure allows for all roles to be integrating roles

Integrating Mechanisms

Figure 13.8: Formal Integrating Mechanisms

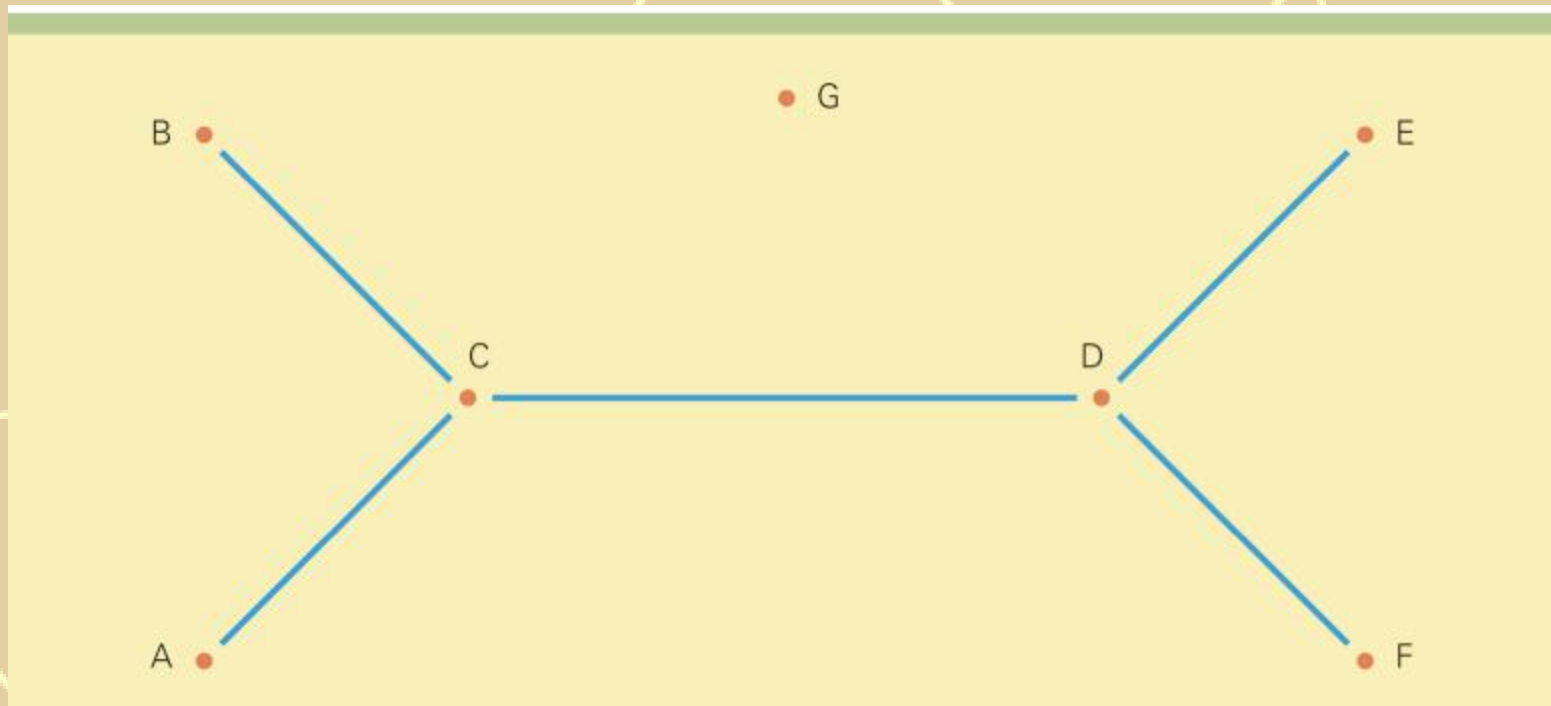


Integrating Mechanisms

- ❖ Many firms are using informal integrating mechanisms
- ❖ A **knowledge network** is a network for transmitting information within an organization that is based not on formal organization structure, but on informal contacts between managers within an enterprise and on distributed information systems
- ❖ A knowledge network is a non bureaucratic conduit for knowledge flows
- ❖ To be successful, a knowledge network must embrace as many managers as possible and managers must adhere to a common set of norms and values that override differing subunit orientations

Integrating Mechanisms

Figure 13.9: A Simple Management Network



Controls Systems And Incentives

- ❖ A firm's leaders need to ensure that the actions of subunits are consistent with the firm's overall strategic and financial objectives
- ❖ This is achieved through control and incentive systems

Types Of Control Systems

There are four main types of control systems:

1. Personal controls – control by personal contact with subordinates

❖ Most widely used in small firms

2. Bureaucratic controls – control through a system of rules and procedures that directs the actions of subunits

❖ The most important bureaucratic controls are budgets and capital spending rules

Types Of Control Systems

3. Output controls – setting goals for subunits to achieve and expressing those goals in terms of relatively objective performance metrics

❖ Control is achieved by comparing actual performance against targets and intervening selectively to take corrective action

4. Cultural controls – exist when employees “buy into” the norms and value systems of the firm

❖ Firms with strong culture have less need for other forms of control

Classroom Performance System

Which is *not* one of the four types of control systems?

- a) Cultural control
- b) Personal control
- c) Input control
- d) Bureaucratic control

Incentive Systems

- ❖ **Incentives** are the devices used to reward behavior
- ❖ Incentives are usually closely tied to performance metrics used for output controls

Incentives:

- ❖ should vary depending on the employee and the nature of the work being performed
- ❖ should promote cooperation between managers in sub-units
- ❖ should reflect national differences in institutions and culture
- ❖ can have unintended consequences

Control Systems, Incentives, And Strategy In The International Business

- ❖ The key to understanding the relationship between international strategy, control systems and incentive systems is **performance ambiguity** - which exists when the causes of a subunit's poor performance are not clear
- ❖ The cost of control rises as performance ambiguity increases

Control Systems, Incentives, And Strategy In The International Business

Performance ambiguity:

- ❖ is common when a subunit's performance is dependent on the performance of other subunits
- ❖ is lowest in firms with a localization strategy
- ❖ higher in international firms
- ❖ still higher in firms with a global standardization strategy
- ❖ and highest in transnational firms

Control Systems, Incentives, And Strategy In The International Business

Table 13.1: Interdependence, Performance Ambiguity, and the Costs of Control for the Four International Business Strategies

Strategy	Interdependence	Performance Ambiguity	Costs of Control
Localization	Low	Low	Low
International	Moderate	Moderate	Moderate
Global	High	High	High
Transnational	Very High	Very High	Very High

Processes

- ❖ **Processes** refer to the manner in which decisions are made and work is performed
- ❖ Many processes cut across national boundaries as well as organizational boundaries
- ❖ Processes can be developed anywhere within a firm's global operations network
- ❖ Formal and informal integrating mechanisms can help firms leverage processes

Organizational Culture

- ❖ Culture refers to a systems of values and norms that are shared among people
- ❖ Organizations have their own values and norms that employees are encouraged to follow
- ❖ Organizational culture tends to change very slowly

Creating And Maintaining Organizational Culture

Organizational culture comes from:

- ❖ founders and important leaders
- ❖ national social culture
- ❖ the history of the enterprise
- ❖ decisions that resulted in high performance

Organizational culture can be maintained through:

- ❖ hiring and promotional practices
- ❖ reward strategies
- ❖ socialization processes
- ❖ communication strategies

Organizational Culture And Performance In The International Business

- ❖ Managers in companies with a “strong” culture share a relatively consistent set of values and norms that have a clear impact on the way work is performed

A “strong” culture:

- ❖ is not always good
- ❖ may not lead to high performance
- ❖ could be beneficial at one point, but not at another

- ❖ Companies with adaptive cultures have the highest performance

Synthesis: Strategy And Architecture

❖ What is the interrelationship between the four basic strategies (localization, international, global standardization, and transnational) and organization architecture?

Synthesis: Strategy And Architecture

Table 13.2: A Synthesis of Strategy, Structure, and Control Systems

Structure and Controls	Strategy			
	Localization	International	Global Standardization	Transnational
Vertical differentiation	Decentralized	Core competency more centralized; rest decentralized	Some centralization	Mixed centralization and decentralization
Horizontal differentiation	Worldwide area structure	Worldwide product divisions	Worldwide product divisions	Informal matrix
Need for coordination	Low	Moderate	High	Very High
Integrating mechanisms	None	Few	Many	Very many
Performance ambiguity	Low	Moderate	High	Very high
Need for cultural controls	Low	Moderate	High	Very high

Localization Strategy

Firms pursuing a **localization strategy** focus on local responsiveness.

- ❖ They do not have a high need for integrating mechanisms
- ❖ Performance ambiguity and the cost of control tends to be low
- ❖ The worldwide area structure is common

International Strategy

Firms pursuing an **international strategy** create value by transferring core competencies from home to foreign subsidiaries.

- ❖ The need for control is moderate
- ❖ The need for integrating mechanisms is moderate
- ❖ Performance ambiguity is relatively low and so is the cost of control
- ❖ The worldwide product division structure is common

Global Standardization Strategy

Firms pursuing a **global standardization strategy** focus on the realization of location and experience curve economies.

- ❖ Headquarters maintains control over most decisions
- ❖ The need for integrating mechanisms is high
- ❖ Strong organizational cultures are encouraged
- ❖ The worldwide product division is common

Transnational Strategy

Firms pursuing a **transnational strategy** focus on simultaneously attaining location and experience curve economies, local responsiveness, and global learning.

- ❖ Some decisions are centralized and others are decentralized
- ❖ The need for coordination is high
- ❖ An array of formal and informal integrating mechanisms are used
- ❖ The cost of control is high
- ❖ A strong culture is encouraged
- ❖ Matrix structures are common

Environment, Strategy, Architecture, And Performance

For a firm to succeed, two conditions must be met:

1. the firm's strategy must be consistent with the environment in which the firm operates
2. the firm's organization architecture must be consistent with its strategy

Organizational Change

- ❖ Firms need to change their architecture to reflect changes in the environment in which they are operating and the strategy they are pursuing

Organizational Inertia

- ❖ Organizations are difficult to change

Sources of inertia include:

- ❖ the existing distribution of power and influence
- ❖ the current culture
- ❖ senior managers' preconceptions about the appropriate business model or paradigm
- ❖ institutional constraints

Implementing Organizational Change

There are three basic principles for successful organization change:

1. Unfreeze the organization through shock therapy

❖ Effective change requires taking bold actions like plant closures or dramatic structural reorganizations

2. Moving the organization to a new state through proactive change in architecture

❖ Movement requires a substantial change in the form of a firm's organizational architecture so that it matches the desired new strategic posture

❖ Movement should be done quickly

3. Refreeze the organization in its new state

❖ Refreezing requires that employees be socialized into the new way of doing things

Classroom Performance System

Which type of organizational structure is often associated with a transnational strategy?

- a) worldwide area division
- b) worldwide product division
- c) matrix
- d) international division