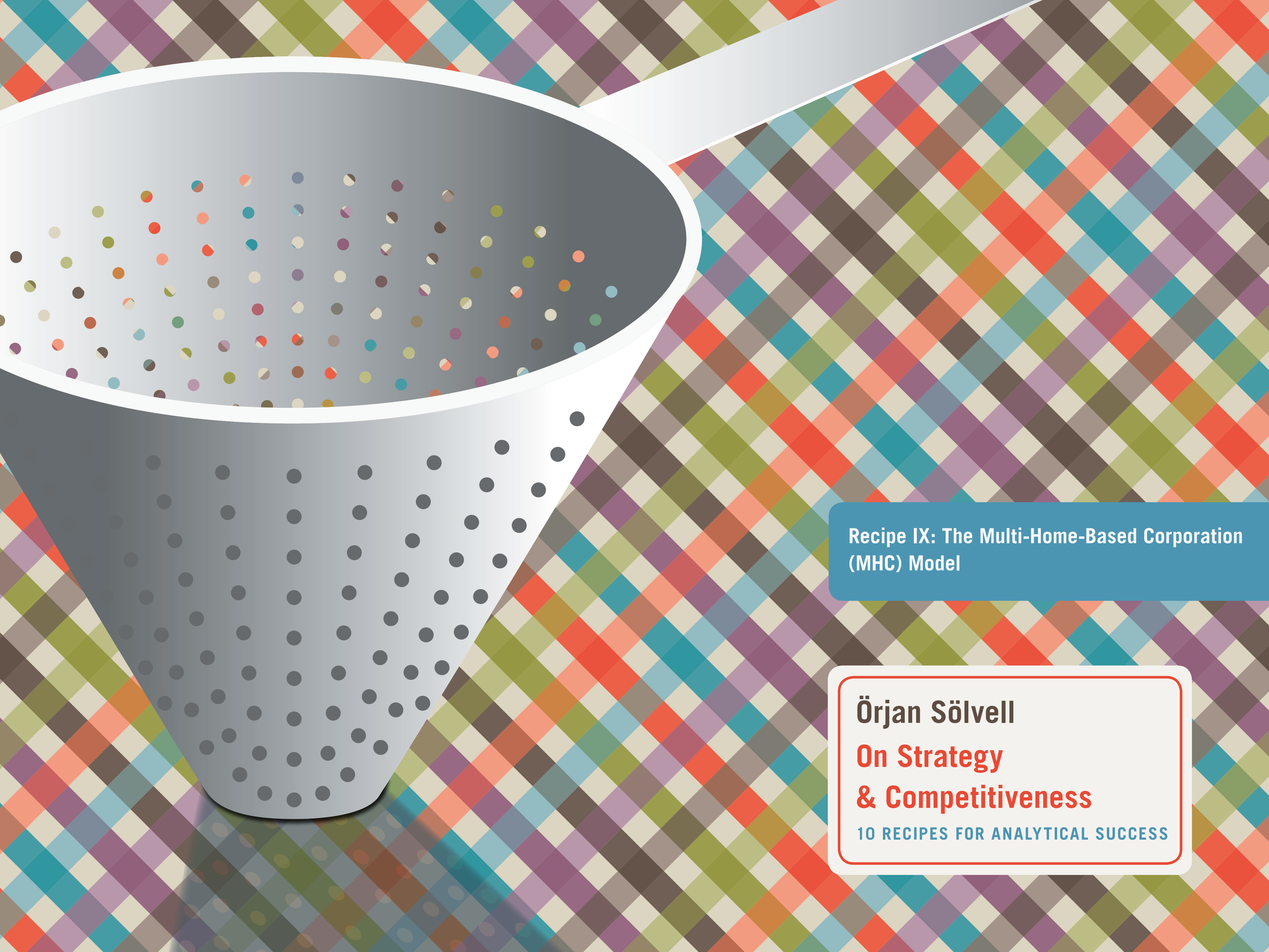

Recipe IX: The Multi-Home-Based Corporation (MHC) Model

Örjan Sölvell

On Strategy & Competitiveness

10 RECIPES FOR ANALYTICAL SUCCESS

IX The Multi-Home-Based Corporation (MHC) Model

Ingredients

- ✓ *Multinational corporations*
- ✓ *Competitiveness and innovativeness*
- ✓ *Global organization*
- ✓ *Home bases*

Introduction

Today, most goods, services and factors of production, including capital, technology and skilled people, face global competition. Globalization has allowed companies, for example in manufacturing, to slice up value chains so that materials, components and products crisscross world markets. A steel leg for a chair might begin its life cycle in Sweden, go to the U.K. for assembly, then back to central warehousing in Sweden, and then back to the U.K. to be sold in a store. Also service companies utilize global chains.

International transactions are carried out through efficient export/import markets, but a substantial part of those global flows is managed by multinational corporations (MNC). MNCs control networks of subsidiaries and manage webs of alliance partners and contract partners across the world. Thus, the modern MNC is entangled in global value chains, with both in-house units and external partners carrying out headquarter functions (strategy, legal, finance, HR, PR, communication, branding); R&D, design and engineering; manufacturing (components, subsystems, final products) and assembly/packaging; procurement, logistics and warehousing; and sales and service operations in multiple locations. Some units are highly integrated into a global whole, whereas other units are given considerable autonomy. Sometimes, subsidiary units controlling strategic resources and capabilities such as headquarter functions and/or R&D, are given a status of "centers of excellence"[45], where subsidiaries take on, or are given, roles outside the confines of the local market. Such center mandates are typically driven by both internal and external factors.

Parallel to increased globalization, we have also witnessed a process leading to an increasingly strategic role for particular regional/local environments, i.e., world-class clusters (see Recipe VIII). Clusters have become hotspots for innovation and economic prosperity. In a world of global flows, the "Hollywoods" of the world have increased their attraction of mobile resources – including talented people (students, researchers, entrepreneurs, inventors and other skilled people), technologies/patents, venture capital, portfolio investments, and, not the least, foreign direct investment from MNCs. The more resources and capabilities can move around the globe, the more specialized and differentiated we expect the world to become. Whereas certain regions and clusters will erode in this process, others will attract resources, leading to continued cluster growth and competitiveness. These structural changes create challenges for the modern MNC, which must handle both globalization and localization forces, in order to stay on the competitive edge.

The modern MNC is often conceptualized as a collection of globally dispersed units possessing distinctive competences and knowledge. We would argue that one of the main strategic challenges facing top management in today's MNCs, is to configure and coordinate resources and competencies in such a way that the efficiency of global markets is combined with innovativeness and knowledge creation emanating from world leading clusters. Important strategic and organizational choices include: should strategic subsidiary units be tightly interconnected or should the MNC allow for independent functional centers of excellence or even multiple home bases? Can the global firm tap capabilities and technologies from afar or must the MNC invest (e.g., through M&A) to become an insider in leading clusters? And what are the organizational implications of increased "insiderization" into host clusters – will fully embedded units fit into a globally integrated MNC?

With parallel globalization and localization forces at play, MNCs face numerous strategic and organizational choices. MNCs typically benefit from globalization, selling their products worldwide and utilizing standardized markets for factors of production to enhance overall efficiency of the firm. In addition to enhancing economies of scale, MNCs utilize global markets to access standardized low-cost labor through offshoring, sourcing of technology (through licensing and other agreements), financial capital, and other tradable resources. Localization forces, on the other hand, seem to be more challenging to corporate management. Tapping locally bound capabilities and gaining access to local networks from afar pose many challenges to an outsider, but can be selectively tapped, for example through scanning units in host clusters.[46] Some argue that MNCs cannot just tap selectively but must have the ability to tap any resource or capability in every location. However, as we will develop further below, an insider/outsider dilemma can arise for the MNC when utilizing global markets for innovation purposes. The more critical technologies and skills are often not traded globally for competitive reasons, and cannot be easily tapped from afar, due to their embeddedness and tacit nature. In order to circumvent these problems, MNCs can choose to build insider positions in clusters through long-term greenfield investment or M&A. However, with increased "insiderization" of the subsidiary unit, controlling strategic and often unique resources and capabilities within the MNC, a counterforce of "outsiderization" is likely to emerge.

We argue that the popular argument that capabilities, knowledge and technology are now "global goods", and that therefore innovation is a global process, is seriously flawed. Innovation processes should not be equated with global value chains of standardized components, goods and services. In other words, the analysis of MNCs and their levels of efficiency and competitiveness should be separated from their innovation processes and degree of innovativeness. This recipe will propose a general model of the global MNC, encompassing both globalization and localization aspects: the multi-home-based corporation (MHC). The MHC solution, we argue, can mitigate the dilemma of increased insiderization in host clusters, leading to increased outsiderization of subsidiary units within the overall MNC.

Four Strategy Elements Facing the MNC and Three Solutions

In a world of increased competitive pressures, MNCs must not only improve their operational efficiencies and cost position, i.e., their competitiveness, but also sustain and enhance their innovativeness. Global markets are central for MNCs' cost position, while insider positions in clusters are central for their innovation processes, especially in open innovation processes where links to external actors, including users, are crucial. In the classic economics sense, firms are competitive when they face relatively lower input costs (land, energy, taxes, wages, etc.) compared to competitors in other nations. In this model, government subsidies, favorable access to natural resources and currency depreciation make indigenous firms more competitive. While such advantages are important to MNCs, increased competitiveness only constitutes part of the fundamentals of sustaining competitive advantage. Sustained competitive advantage is primarily built on the firm's ability to continuously upgrade and create new products and processes to meet changes in demand and technology. Therefore, MNCs must take both competitiveness and innovativeness into account as they configure and coordinate units around the world.

If we combine the two dimensions of efficiency-seeking and innovation-seeking strategies, along with global and local outlooks, as outlined above, we arrive at a matrix with four corners (see Figure 1), each representing a critical strategy element. The upper left corner involves innovativeness emanating from clusters. The upper right corner focuses on innovation as a global process, often referred to as the transnational solution, combining resources and capabilities from several locations. Here, the tapping of resources and capabilities in host locations is not seen as creating significant problems. The lower left corner covers strategies of cost efficiency, with emphasis on the home market (often true for MNCs with large home markets), and the lower right corner covers global efficiency and global cost leadership.

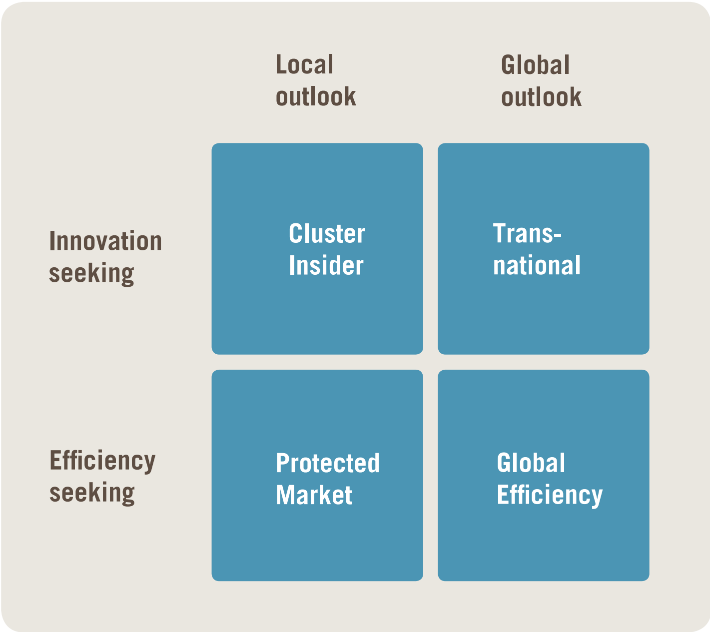

Figure 1. Four Strategy Elements Facing the MNC

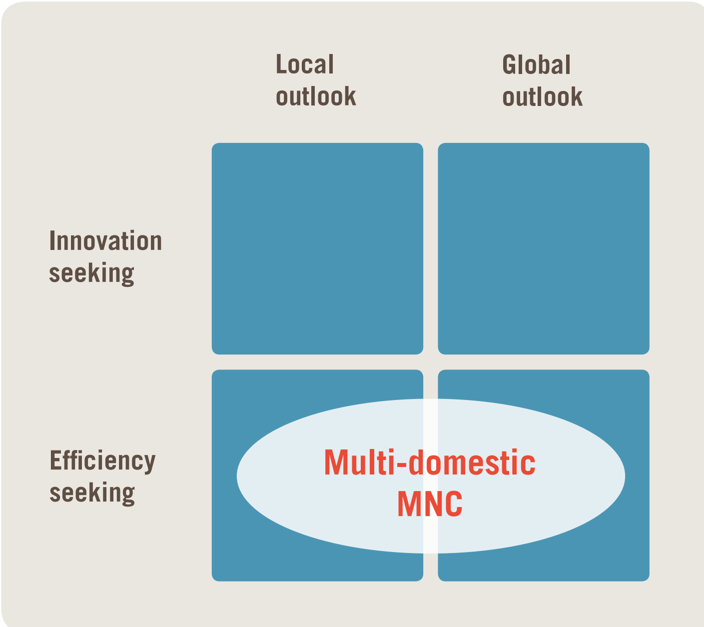

Figure 2. The Multi-Domestic MNC

MNCs tend to combine different elements of the matrix, and we will point to three important baseline models, each combining two elements. Two of these models are found in the mainstream literature on MNCs, and the third, the MHC, is the core of this recipe.

The Multi-Domestic Corporation

Leading MNCs from small home countries have been very successful in achieving high levels of competitiveness through global markets. By selling their products and systems across international markets, they have been able to exploit advantages of scale comparable to firms from larger markets. Gradually, MNCs from smaller countries managed to achieve further gains in cost-effectiveness by establishing assembly and production units in larger markets, sometimes also for reasons of protectionism or government demands. Instead of carrying one home flag, these MNCs carry many flags and have many "homes". The strategy has been characterized as multi-domestic, where the MNCs seek to combine efficiencies of global and local markets. In manufacturing industries, core components and subsystems are produced at a global scale in a few locations, whereas assembly and local adaptation is done on a country-by-country basis. Global outsourcing of products and components has also been central feature of multi-domestic MNCs.

The Transnational Corporation (TNC)

The transnational model came up as an answer to increased globalization, and with the advent of more sophisticated MNCs in the 1980s that had highly dispersed networks of subsidiaries. A central feature of the model is that it not only involves global efficiency-seeking but also global innovation and resource-tapping for global reach.[47] The primary concern of the TNC strategy is how to foster the development and integration of internationally dispersed resources and capabilities on a worldwide scale. Exactly how TNCs should go about learning and creating new practices on a global scale was mainly theoretically derived, underpinned by a few case studies.

In spite of its intuitive attractiveness, we would argue that transnational strategies have proven problematic. Attempts within TNCs to create new solutions through global teams have turned out to be miscalculations as a result of high costs and major delays.[48] To learn and share across the globe is appealing, but it involves significant costs and major organizational barriers.

We would argue that a majority of international business scholars today are pointing to advantages of global strategies and structures akin to the transnational model. Even though we see few studies of these globally linked innovators, many scholars argue that it is only a matter of time, due to a growing sophistication of MNCs. However, a number of traditionally under-emphasized factors should be considered when assessing the degree to which global innovation is or may become a major force in the MNC model. First, introduction of internationally integrated innovation projects requires implementation of systems that reward involvement in projects that are temporary and fall between national organizational entities. These systems seem hard to come by spontaneously, and many managers we have met testify that involvement in temporary projects that lack an organizational home does not help individual careers. Second, the cross-border context also adds complexity in that dispersed units tend to have their own identity and understanding of what constitutes an effective development process. Unless projects that cut across different national units are carried out with regular frequency, these differences will continue to have a negative effect on inter-unit collaboration and the effectiveness of cross-border innovation. Third, an important part of local knowledge creation and innovation is context-dependent, and therefore the absorptive capacity of other units of the MNC is limited, and fourth, information processing in the modern multinational is not necessarily based on objective data, and thus the difficulties involved in agreeing about which skills reside where, and a lack of willingness to share them

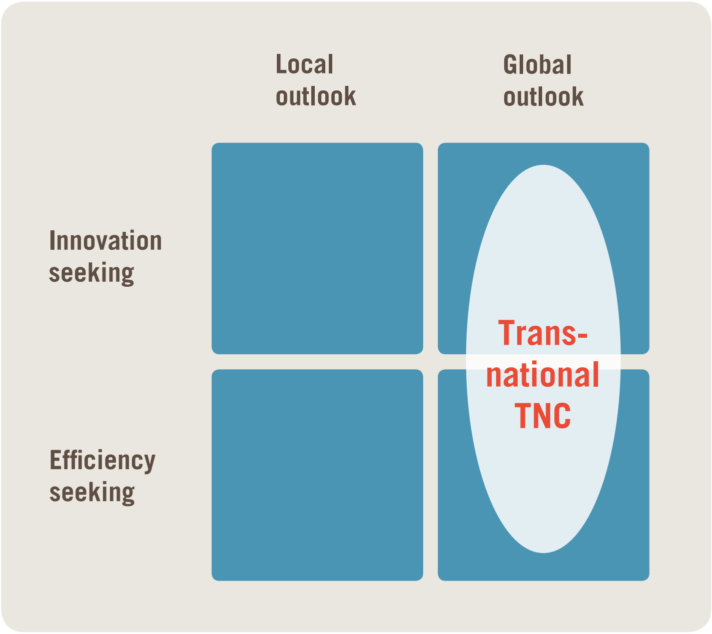

Figure 3. The Transnational Corporation (TNC)

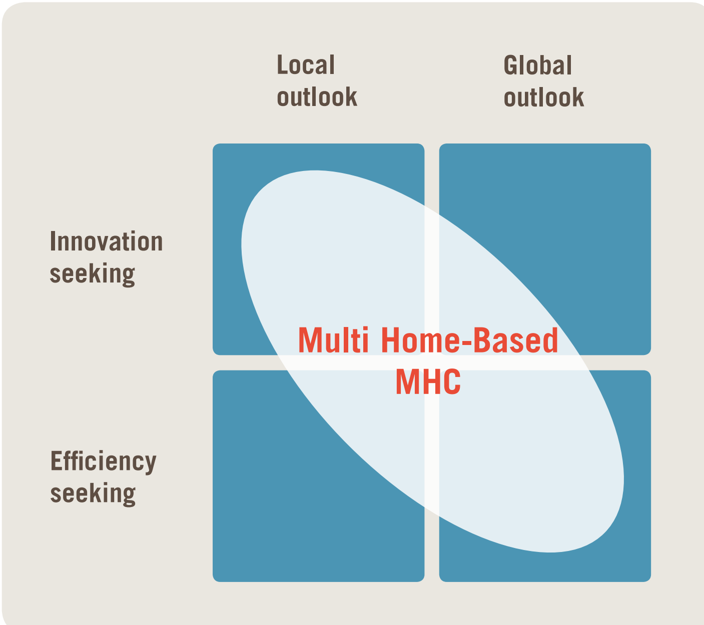

Figure 4. The Multi-Home-Based Corporation (MHC)

among subsidiaries (the NIH syndrome), will hamper any attempts at global innovation.[49]

The Multi-Home-Based Corporation (MHC)

The MHC recipe builds on the notion that innovation is a highly complex and localized process, and that corporate units (both local firms and MNC subsidiaries) are entangled in various ways within their local clusters. Clusters range from globally competitive to more regional ones, and for MNCs it is critical to have major operations in world-leading clusters in their fields of technology. The model also builds on the notion that in order to stay competitive, it is not enough to assign a center of excellence status along functional lines to particular subsidiaries. The MHC should co-locate strategic resources (divisional HQ functions, divisional R&D, design, manufacturing, etc.) into home bases. Just as firms once emerged in their home market, building a home base for further expansion, the MHC model takes this one level further and combines the MNC into a set of somewhat autonomous divisional home bases.[50] We hypothesize that this model is more attractive for MNCs from smaller home countries, where the original home base (i.e., home market) never wielded a significant influence.

The strategy for success in an MHC relies on both ensuring innovativeness through insider positions in one or more leading clusters and ensuring efficiency by means of a global strategy for production, sourcing and sales (Figure 4). As most MNCs are diversified to a certain degree, each line of business needs to find its home base. These home bases become more or less independent centers, developing their own strategies and organizational models. The home base unit (with business headquarters, R&D, design, and in manufacturing industries, core manufacturing operations) plays a global role. In addition, organizational resources, including sales subsidiaries and local partners involved in market penetration, are spread around the world to ensure maximum competitiveness through global efficiency and scale.

The MHC is a distinct model implying a certain set of strategic and organizational choices. It is different from the multi-domestic model in that it emphasizes the role of innovation. It is also different from the traditional home-country MNC as it allows for different home bases, not necessarily in the original home country. It is also different from the transnational model in that it downplays globally linked innovation projects, intense skill transfers and cross-country combinations. Instead of building increasingly complex organizational forms, in order to integrate complicated processes of innovation around the world, the MHC model puts emphasis on simple organizational structures, with clear home bases for each line of business, and a strict hierarchy between strategic activities critical for innovativeness (home base) and other activities critical for enhanced efficiency and competitiveness (sales subsidiaries and externally contracted partners). If there is a need for interaction between home bases, whether for technological or customer support reasons, the bases can be organized in such a way that dependencies become sequential, where each base has a clear mandate, e.g., for a specific part of the value chain. Simple interfaces are important in the MHC model to ensure an efficient hand-off of the baton.

It is often argued that MNCs invest abroad as a means to tap knowledge from host business contexts, and that the competitive success of the MNC can be explained by its ability to accumulate and integrate knowledge from different parts of the world. Thus, one would argue that with increased tapping of world-leading clusters, the modern MNC would not need any particular home base or bases. There are many studies showing increased levels of foreign patenting. That could be interpreted as indicating that the process of knowledge creation in the MNC has become global. However, nothing is said about whether 1) the new knowledge was later successfully exploited throughout the MNC and 2) the new knowledge was a result from cross-border innovation and learning. If the answers to these two questions are negative, foreign patenting can be interpreted as a result of the use of home bases, particularly if there is little or no overlap in the patenting (i.e., technologies) across subsidiary units.

Solving a Dilemma

The main argument for configuring and coordinating the MNC along the MHC model is to solve an apparent dilemma. Take the following example. A multinational firm is entering a foreign market and has built some local sales and service capabilities. The subsidiary unit has a clear target of penetrating the market. Technology and strategic resources reside elsewhere in the MNC. In Figure 5 below, we would find this unit in the lower right corner, depicted as an outsider in the host cluster and an insider within the corporation. The outsider position in the host business environment means that the subsidiary and its staff are not part of core networks (social clubs, informal networks, etc.) and are less likely to be involved in innovation processes in the host cluster. For example, a sales subsidiary of a European car manufacturer in Tokyo is not at all integrated into the automotive clusters of Japan, including the famous "Toyota City". Over time, many of the world's leading MNCs have built insider positions across a range of countries, either through long-term greenfield investments or through M&A (Figure 6). It is common in high technology areas that global corporations acquire smaller companies in leading clusters such as Silicon Valley to access new technology and new customers.

So far, this seems rather unproblematic. Through increased commitment in the host country, the MNC builds more of an insider position, opening up for the tapping of the host technology and skills. To be an insider in a host cluster is essential in order to benefit from spillovers – and the MNC will end up with embedded subsidiaries controlling unique capabilities and resources. However, we argue that subsidiary units possessing unique technologies, resources and capabilities are likely to build semi-autonomous positions within the corporation (see the four arguments against globally linked innovation processes in conjunction with the TNC model discussed above). To share and link units in various ways becomes more problematic and often involves increased coordination costs. Thus, we expect such

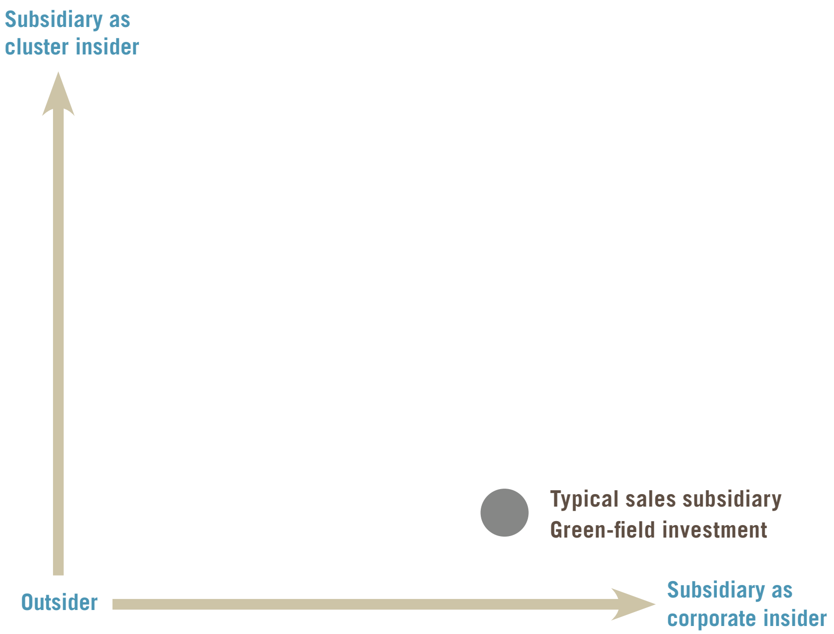

Figure 5. Two Dimensions of Clusters and Corporate Insiders/Outsiders

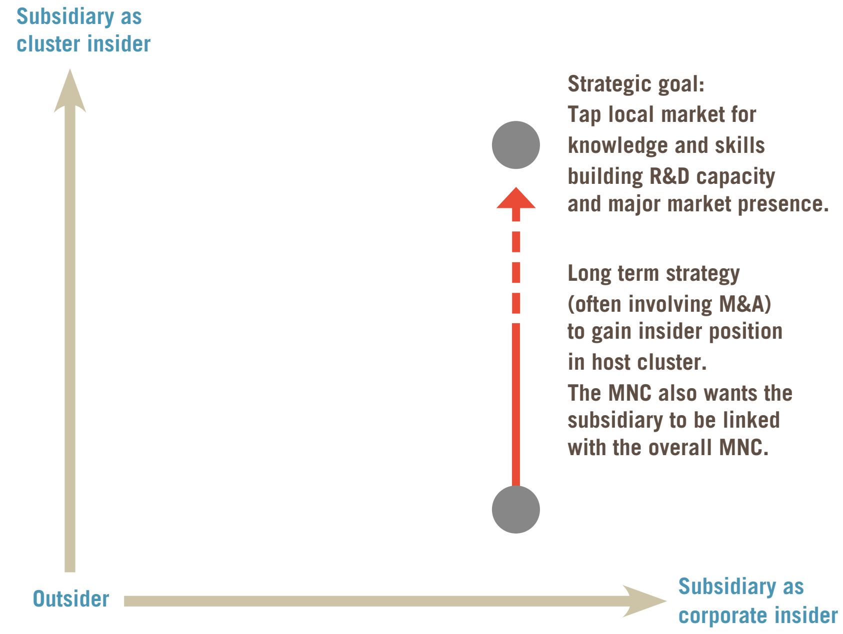

Figure 6. Building an Insider Position in a Host Cluster

embedded subsidiary units to end up in the upper left corner, rather than the sought-after upper right corner (Figure 7).

IBM can be seen as an example of what we mean by the MHC model. When the company was more of a technology and product firm, some technologies and products were based in the U.S. (mainframes), whereas others were concentrated in China (laptops). The laptop business was sold to Chinese firm Lenovo in 2005. Now, as a software and service company, IBM has several bases, one of which is in China. For example, the IBM China Research Laboratory in Zhongguancun Software Park, in Beijing's academic cluster, specializes in speech and language technologies and cross-border e-business solutions for the whole of IBM.

Large mergers (e.g., Astra merging with Zeneca; Merck & Co. with Schering-Plough; Siemens merging with Nokia in the telecom network business and now with Alcatel-Lucent; Microsoft and Nokia merging in the handset business, etc.), often leads to a duplication of home bases (R&D centers, regional headquarter units, etc.). Using the MHC model, you must eliminate some of the overlapping units, for example through a process of internal competition. Product and technology mandates are shifted around to facilitate simplification, and leadership is transferred to one base. We think the MHC model is more suitable in industries where there are clear world-leading clusters, i.e., "Hollywoods". There are, of course, advantages and disadvantages with such a strategy and organizational model, but in a world of global competition facing MNC executives today, we would argue that this model has a lot to offer in terms of ensuring both high levels of efficiency and high levels of innovativeness. Maybe MNCs from small home countries, with a less influential original home base, have been more prone to move towards the MHC model, and thus could act as inspiring examples.

MNCs need to innovate to survive and prosper, and in the light of this recipe, how can global firms handle the apparent need to both build on superior market contacts and internal resources concentrated to home bases? This is the question we turn to in our last recipe, Recipe X.

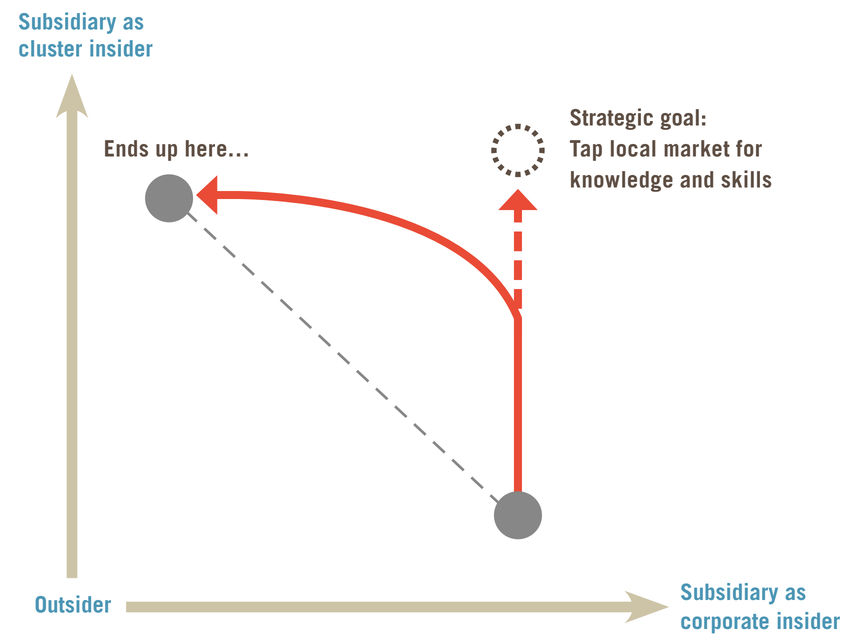

Figure 7. The Insider-Outsider Dilemma

Your own notes: