

**The Multi-Home Based Multinational -
Combining Global Competitiveness and Local Innovativeness**

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1. Introduction

Cross-border economic activity seems to increase at an ever-increasing speed. We have witnessed the establishment of global markets for many goods, services and factors of production including capital, technology and skilled people. These flows are to a large extent managed through multinational corporations (MNC) with global networks of subsidiaries and alliance partners. With increased globalization we have also witnessed a parallel process leading to an increasingly strategic role for particular local environments, such as Hollywood the world's leading featured film, TV and entertainment cluster. In a world of globalization it seems as if these 'Hollywoods', in both old and new industries, increase their attraction on mobile resources: talented people; technologies; venture capital and other financial capital; direct investments by MNCs – from around the world.

The more resources and capabilities move around the globe the more specialized and differentiated the world will become¹. Take a recent example. People, firms and technologies linked to the pharmaceutical and biotech industries are constantly looking for the most attractive regions, exhibiting world-class universities and R&D operations of leading MNCs. Today, three countries constitute the home bases of 13 of the top 15 companies in the world: United States, Switzerland and Great Britain. In the global filtering process now taking place the United States seems to out-compete much of the world, and within the United States, New Jersey, and the San Diego and Boston areas seem to out-compete most other potential locations. A few global 'Hollywoods' are emerging in pharmaceuticals and biotech.

In the spring of 2002, the main Swiss player, Novartis, announced that they would move their global R&D headquarters to the United States and Boston. And long before that, prior to World War II, Swiss pharmaceutical firms began investing in R&D operations in New Jersey. Not only do large MNCs make these kinds of strategic choices, it also trickles down the attraction of students, researchers, entrepreneurs, inventors and other skilled people. Hence, the increased mobility not only of goods and services but also of all kinds of factors of production, is creating a world based on a 'new geography'.

Somewhat paradoxically, increased globalization goes hand in hand with increased localization in this new geography.

Corporate executives are now facing critical strategic and organizational choices in a world of increased globalization and localization. MNCs typically benefit from globalization, selling their products worldwide and utilizing markets for factors of production, and input goods and services to enhance overall efficiency of the firm. Localization forces, on the other hand, seem to be more challenging to corporate management. Local markets have, of course, outplayed their role for most goods and services, but dynamic local clusters of interrelated industries and specialized institutions are playing increasingly important roles as centers for corporate innovation, and constitute “home bases” for continuous upgrading of competitive advantage. Should we develop home bases or spread out core functions to maximize global coverage? Should we move our home base to a more dynamic cluster? Can we tap capabilities from afar or should we invest to become insiders in certain ‘Hollywoods’? Should we link different core subsidiaries/home bases or should they play more independent roles? These are some of the fundamental strategic and organizational challenges facing MNC executives today. We would argue that they have less to do with globalization and operational efficiency, what we label competitiveness. Instead, these concerns have to do with need for continuous upgrading of products, process technologies and all sorts of critical capabilities inside the firm, or what we label innovativeness that in turn is intimately linked to the forces of localization. One of the main strategic challenges facing top management in today’s MNCs is therefore to configure and coordinate international activities in such a way that the efficiency of global markets is combined with innovativeness emanating from world leading clusters.

In this chapter we will outline a simple model of how MNCs can build competitive advantage through a combination of *innovativeness* and *competitiveness*, taking into consideration the forces of *globalization* and *localization*. The chapter begins with a discussion of the new geography – combining globalization and localization forces, moves on to issues of innovativeness and competitiveness of MNCs, and ends up with a

discussion of a model combining the two dimensions. Three main strategies for MNCs are outlined, of which one – the multi-home based multinationalⁱⁱ - is argued to hold the most promise in the emerging new geography.

2. The New Geography - Globalization and Localization

Rather than a new economy, where demand and supply curves are turned on their heads and scale economies are rendered obsolete, we have a new geography. This new geography ought to be taken seriously by MNC executives; what do forces of ‘globalization’ imply for our strategy and operations, and what do forces of ‘localization’ imply for our strategy and operations. In this section, we will only touch upon the issues of globalization and its potential for MNCs as this is well understood, and instead turn to the localization aspects.

In most industries today, global markets offer a road to enhanced efficiency through improved economies of scale in varying parts of the value chain: R&D, sourcing of materials, components or systems, manufacturing, or marketing and sales. Depending on homogeneity of demand, trade restrictions, transportation costs and homogenization of technology, global sales can involve more or less local adaptation and design and more or less dispersion of packaging, assembly, testing, and full production. The more a firm faces one homogenous market, with little or no trade barriers, and the lower the transportation costs (e.g. in the case of digital products transferred over Internet), the more one global source for development and production can be used. However, in many industries today some fragmenting forces still prevail, forcing MNCs to run dispersed operations, often reducing some of the potential global scale advantages.

In addition to enhanced economies of scale, global markets should be used to its maximum to get access to pools of standardized low-cost labor (e.g. software engineers or export platforms in emerging markets), codified technology (through licensing and other agreements), financial capital, and other tradable resources. Through trade shows, travel and local scanning operations, the global market can be selectively tapped. Some

argue that MNCs cannot just tap selectively but have the ability to tap any resource or capability in every location. However, as we will develop further below, an insider/outsider dilemma typically arises for the MNC 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 investment and acquisitions. However, with increased ‘insiderization’ of the subsidiary unit, controlling strategic and often unique resources and capabilities within the MNC, a counterforce of ‘outsiderization’ relative to sister units within the MNC, typically emerges. In organizational terms this is often translated into formal regional or world mandates referred to as centers of excellence.

Clusters

Tendencies towards cluster formation around cities or smaller regions have long been evident in traditional industries, e.g. car manufacturing around Detroit and southern Germany, pulp and paper in parts of Sweden and Finland, and clothing and shoes in northern Italy. In earlier times, natural factors such as climate and soil, location of raw materials, and endowments in terms of energy (forests, waterfalls etc.) and transportation routes (rivers, natural ports etc.) played an important role in the location of industries and whole clusters. Pure acts of entrepreneurship have also come into play, such as in the much-cited case of carpet manufacturing in Dalton, Georgia. Access to specialized skills and advanced markets has been decisive for patterns of economic agglomeration in service industries such as financial services in London and on Wall Street, fashion in Paris, auction houses in London and advertising offices on Madison Avenue.

Agglomeration of economic activity on a global scale, such as in the case of Hollywood, is maybe most pronounced in technology-intensive industries such as pharmaceuticals, biotech, telecommunications, consumer electronics, computers and IT.

But why are local clusters so critical to innovation? We think there are three critical arguments as to why innovation processes tend to be highly localized:

- the need for incremental reduction of technical and economic uncertainty,
- the need for repeated and continuous interaction between related firms and specialized institutions (including research and education), and
- the need for face-to-face contacts in the exchange and creation of new knowledge.

The first characteristic derives from the fact that innovative processes are fundamentally uncertain in terms of technical feasibility and market acceptance. Only few projects turn out to be commercial successes. Even if the level of uncertainty varies with industry and type of innovation, technical aspects are commonly worked out by means of trial and error testing and modification. Incrementalism and trial and error problem solving in turn lead to a need for continuous interaction, both in informal networks and formal cooperation. The two other arguments build on the notion that proximity within clusters adds tremendously to continuity and face-to-face interaction in personal networks that is critical to transfer of more tacit skills (facilitated by common language and training). Finally, innovative sources are often found outside the firm, where again proximate customers, competitors and various institutions play important roles.

In summary, dynamic clusters are characterized by:

- Intense local rivalry involving battles of prestige and ‘feuds’ (in addition to global competition), stimulating continuous upgrading and change, and creating a foundation for a more advanced and diverse supplier base.
- Dynamic competition emanating from entry of new firms, including spin-offs from larger incumbents.
- Intense cooperation organized through various institutions for collaboration such as professional organizations, chambers of commerce and the like. Clusters also exhibit intense informal interaction typically based on personal networks.
- Access to increasingly specialized and advanced factors of production (human capital and financial capital), and access to research in linkages with universities and public/private research institutes.

- Linkages to technologically related industries, sharing pools of talent and new technological achievements.
- Proximity to sophisticated and demanding buyers (B2B or B2C).

The clusters that promise well for the future are not primarily characterized by advantages of scale but rather by a capacity for perpetual innovation and upgrading of goods and services, and a process of increasing specialization and upgrading of human capital and other factorsⁱⁱⁱ. Leading clusters are characterized by an “upward spiral” where incumbent firms gain from, and add to, local spillovers. However, one must not forget that spillover effects have to be created; they do not just arise automatically because industries are co-located. The degree to which interaction takes place resulting in spillovers depends on the legacy of a region, social capital and policy choices.

Firms in clusters have access to specialized and advanced factors of production. The process of factor upgrading is in fact endogenously driven by competition and sophisticated demand inside the cluster. In addition to these local conditions, free and substantial mobility between the cluster and the world around are vitally important if the local environment is to avoid stagnation. To achieve vitality in the long term, local clusters need to be able to attract companies, venture capital, skills and other resources from all over the world, what we have termed the “Greta Garbo-effect”. Firms inside a cluster must also have good access to world markets to be able to sustain its efficiency and competitiveness. Thus, a dynamic cluster is characterized by three distinct processes: Local dynamism, global attractiveness, and global reach. Since leading clusters are characterized by high costs (wages, land etc.) they run contrary to competitiveness, but are critical for sustained innovativeness among firms, which we turn to next.

3. Competitiveness and Innovativeness

The concept of competitiveness in traditional economics is static and based on cost advantages. Firms are competitive when they face relatively lower input costs (land, energy, taxes, wages etc.) compared to competitors in other nations. With this view

government subsidies, natural endowments and currency devaluations, which fortunately is less of a tool today, make indigenous firms more competitive. It is true that lower costs creates a potential of competing with lower prices for a limited period of time, until you meet an even lower cost competitor in the global marketplace. However, increased competitiveness has little to do with the fundamentals of sustainable competitive advantage, namely the ability to innovate around products and processes and the ability of upgrading resources and capabilities of the firm. In fact, advantageous cost positions tend to work in the opposite direction, slowing down the speed of innovation and change, thus undermining the innovativeness of the firm.

In a world of increased competitive pressures MNCs need not only improve their operational efficiencies but also sustain and enhance their innovativeness. Whereas strategies focusing on global efficiency are easily copied, insider positions in a certain cluster are more firm specific and idiosyncratic and therefore more sustainable.

4. Four Strategy Elements Facing the MNC

If we combine the two dimensions outlined above we receive a matrix with four corners (see Figure 1) each representing a critical strategy element. The upper left-hand corner puts emphasis on the innovativeness emanating from a lead cluster – a ‘Hollywood’. The upper right-hand corner focuses on innovation as a global process, often referred to as transnational solutions, combining resources and capabilities in several locations. The lower left-hand corner covers strategies of cost efficiency with emphasis on the home market (often true for MNCs with large home markets), and the lower right-hand corner global efficiency, i.e. global cost leadership.

	Localization	Globalization
Innovativeness	Cluster insider	Transnational innovation
Competitiveness	Protected market	Global efficiency

Figure 1 Four Strategy Elements

MNCs tend to combine different elements of the matrix, and we will point to three important models each combining two elements. Two of these are found in mainstream literature on MNCs and the third is being identified as a future growth model.

Multi-Domestic MNCs

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 internationally important 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 the vicinity of large markets, or where conditions for particular types of production were better, or for reasons of protectionism or government demands. Instead of carrying one flag these MNCs carried many flags and had many 'homes'. The strategy has been characterized as multi-domestic where the MNC would seek to combine efficiencies of global and local markets. In manufacturing industries, often core components and sub-systems were produced for global scale, whereas assembly and local

adaptation was done by a country-by-country basis. Global outsourcing has also been central to multi-domestic MNCs.

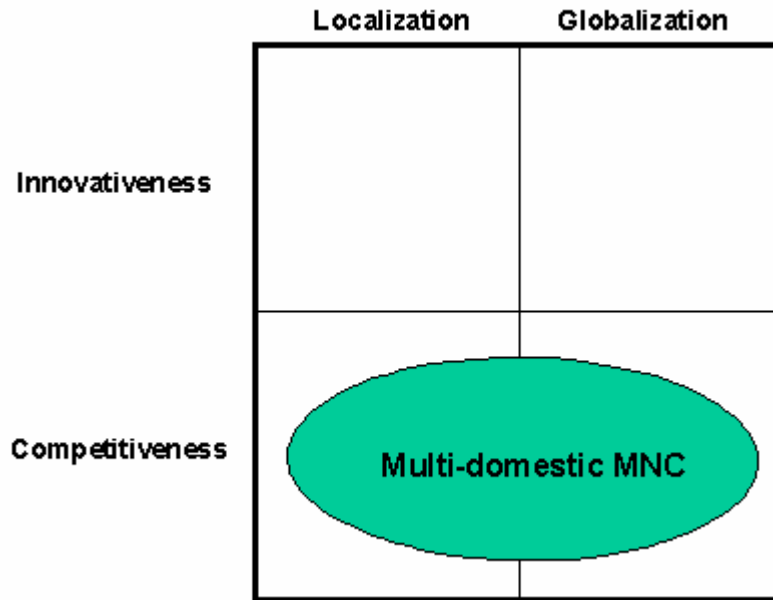


Figure 2 The Multi-Domestic MNC

Over extended periods of time cost efficiency is not enough to guarantee long-term profitability and survival in the market. Long-term competitive advantages are based primarily on innovativeness, i.e. the capacity to benefit customers by continuously innovate and upgrade the content and quality of products and their marketing, production, logistics and so on.

Transnational MNCs

The model of Transnational MNCs came up as an answer to increased globalization and more sophisticated MNCs with highly dispersed networks of subsidiaries.^{iv} A central feature of the model is that it not only involves global efficiency-seeking but also global innovation.

The primary concern of this strategy is thus how to foster the development and integration of internationally dispersed capabilities on a worldwide basis. Exactly how MNCs should go about learning and creating new practices on a global scale was mainly theoretically derived, underpinned by a few case studies. Only recently have a number of empirical projects tried to penetrate the issues of cross-border learning and transfer of skills on a broader basis, and the weaknesses of the model have thus been exposed. Innovation and creation of new knowledge in cross-border settings tend to cost a lot and lead to delays in time-to-market.

In spite of its intuitive attractiveness, we argue that transnational strategies have proven problematic. Attempts within a company to create new solutions by means of innovation projects involving global teams have often turned out to be miscalculations as a result of high costs and major delays. To learn and share all across the globe is appealing, but it involves large costs and organizational barriers.

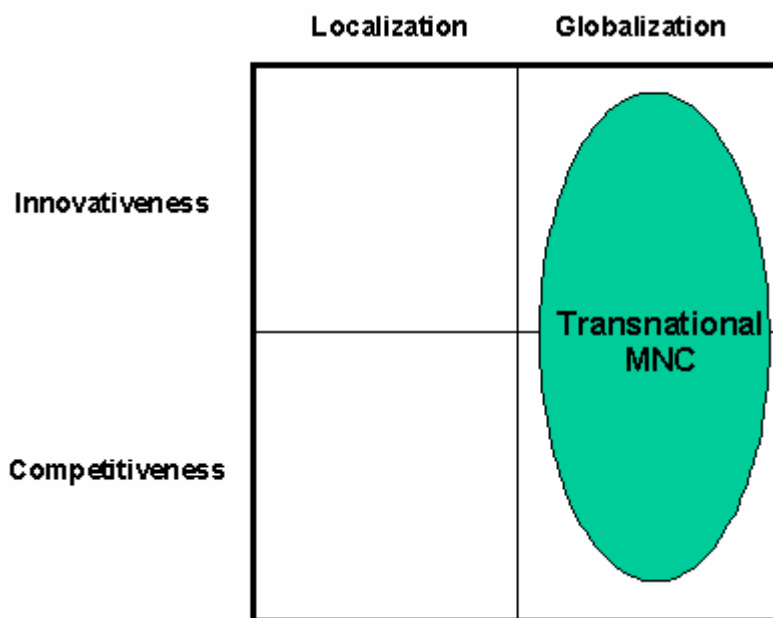


Figure 3 **The Transnational MNC**

Multi-Home Based MNCs

The strategy for success in the new geography is to both ensure innovativeness by building up insider positions in one or more leading local clusters, and to ensure competitiveness by means of a global strategy for production, sourcing and sales. As most MNCs are diversified to a certain degree, each line of business needs to find its home base. Each line of business carries one flag (not necessarily the original home country flag), similar to the traditional MNCs with a clear home country. Depending on the need to link different business units (technology or market driven linkages), these home bases become more or less independent centers, developing their own strategies and organizational models. The home base unit (business headquarters, R&D, design and in manufacturing industries core manufacturing operations) plays a global role. In addition, organizational resources (typically sales subsidiaries and local partners involved in market penetration) are spread around the world to ensure maximum competitiveness through global efficiency and scale.

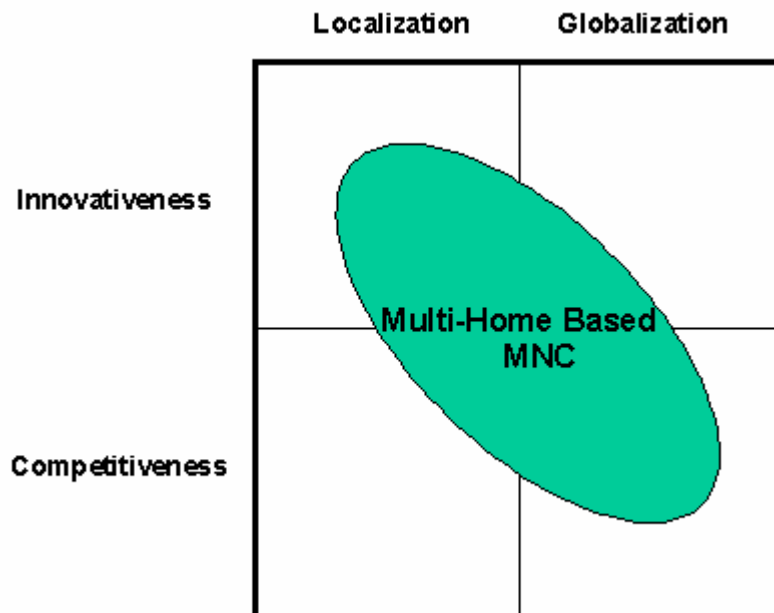


Figure 4 The Multi-Home Based MNC

5. Organization of the Multi-Home Based MNC

Multi-home based MNCs have something in common with federative organization structures where global headquarters is more of a parent ‘set up’ by the children than a parent in tight control of the children. Corporate headquarters should be separated from the different business units (as in the recent case of Boeing where corporate headquarters moved out of Seattle) and have its own location, preferably in a headquarters city such as London. Corporate headquarters play a role in coordinating financial and legal matters, brand coordination and sets overall portfolio strategy. Business unit headquarters, on the other hand, should be co-located with strategic functions in the respective ‘Hollywoods’. We do not believe that the MNC should be geographically split up in terms of core functions, with the exception of corporate world headquarters (and in rare instances corporate R&D), but kept together in units of critical mass in world-leading clusters.

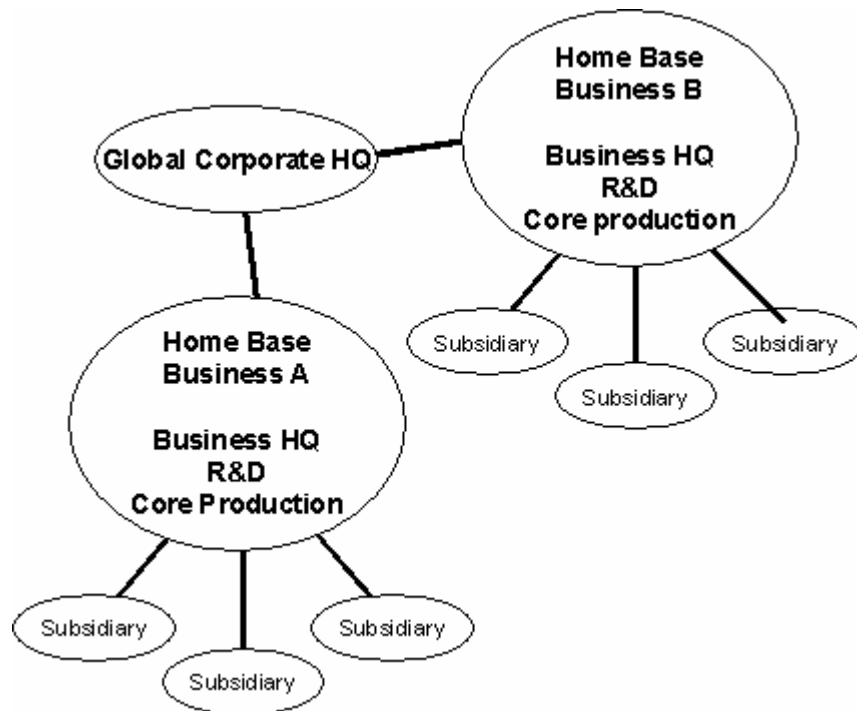


Figure 5 Organization of the Multi-Home Based MNC

To keep an eye on what takes place outside the home base, the multi-home based MNC needs some form of monitoring in regions where it lacks insider positions. To ensure effective tapping from afar, resources and activities (traveling executives and experts, scanning units etc.) should have a clear purpose of transmitting back new technologies and ideas to the home base, and should not be allowed to develop them locally. For example, Boston and Cambridge, Massachusetts, are full of such scanning units surrounding MIT and Harvard.

The multi-home based MNC is a distinct model implying a certain set of strategic and organizational choices.^v 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^{vi} as it allows for different home bases (not necessarily the original home country). It is also different from the transnational model in that it downplays globally linked innovation projects and intense skill transfers. Instead of building more and more complex organizational forms to integrate complicated processes of innovation around the world, the multi-home based 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 (e.g. sales subsidiaries). If there is a need for interaction between home bases, we suggest that the corporation is organized in such a way that dependencies between home bases are sequential, where each base has a clear mandate, e.g. for a part of the value chain. It is important that simple interfaces are created to ensure efficient hand-off of the baton.

How about moving the home base? Following long-term investment and large M&A, MNCs tend to add new home bases. As common result of M&A is a duplication of home bases. Over time, duplication seems to evade when certain units, often through a process of internal competition, become stronger and others weaker. Not surprisingly, the units that tend to become centers of excellence are the ones located in the more dynamic clusters. We have seen cases of smaller MNCs that grew up in one cluster that went into decline, actually move all core resources to 'Hollywood'. However, we would caution

that this is a highly complex process. Often a better long-term strategy is to make sure that the home base strategy also covers strengthening the overall home cluster^{vii}.

A majority of scholars of the MNC argue for strategies and structures akin to the transnational model. Even if we see few of these ‘phantom’ multinationals around, many scholars argue that it is only a matter of time and sophistication of the MNC. We would argue that a number of traditionally under-emphasized factors should be considered when assessing the degree to which global innovation may become a major force in the future multinational. First, introduction of internationally integrated innovation projects require implementation of systems that reward involvement in projects that are temporary and fall in-between national organizational entities. These systems seem hard to come by spontaneously, and most managers would testify that involvement in temporary projects without 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^{viii}. Third, recent findings suggest that information processing in the established multinational is not necessarily based on objective data^{ix}. The difficulties involved in agreeing of what skills reside where, and lack of willingness to share it among subsidiaries, will hamper any attempts of global innovation.

Finally, we want to remind our readers of the insider-outsider dilemma that emerges with the expansion and deepening of involvement in foreign clusters^x. In essence, the process of increasing insiderization – essential in getting access to local cluster spill-overs and the most advanced and specialized human capital - appear to evolve together with processes that build independence and distance between units in the multinational network. Thus, by becoming more of an insider in a local cluster the unit becomes more of an outsider within the MNC. The multi-home based MNC is an attempt to solve this dilemma. There are of course advantages and disadvantages with such a strategy, but in the new

geography facing MNC executives today, we argue that this model has a lot to offer in both ensuring competitiveness and innovativeness.

ⁱ The well-established trade theory also suggests that with open trade nations will specialize where they have “comparative advantage” and the world will tend to become more differentiated. However, in predicting in what areas a certain region or nation will specialize the trade theory is predominantly occupied with endowed factors. In Michael Porter’s seminal work on the competitive advantage of nations the focus is on created factors and the endogenous processes leading to upgrading of factors and increased specialization. See Porter, M.E. (1990) *The Competitive Advantage of Nations*. Macmillan Press. Furthermore, traditional trade theory is based on factor immobility, something that is less true today.

ⁱⁱ The concept of the multi-home based multinational was first presented in a book written jointly with Michael E Porter and Ivo Zander, see Sölvell, Ö., Zander, I., Porter, M. E., (1991) *Advantage Sweden*. Stockholm: Norstedts.

ⁱⁱⁱ Innovation and change became hot management topics during the 1990s. One of the more important insights in the works of Michael Porter, as summarized in the so called diamond model, was that the ability of firms to continuously innovate and change in smaller increments was largely driven by its immediate environment, most importantly the cluster within which the firm had its key resources for a specific line of business.

^{iv} The model was first proposed by Chris Bartlett and Sumantra Ghoshal and has won acclaim around the world. See Bartlett, C.A. and Ghoshal, S. (1989). *Managing across borders: The transnational solution*. Boston, MA: Harvard Business School Press. See also Bartlett, C.A. and Ghoshal, S. (1990). *Managing innovation in the transnational corporation*. In C.A. Bartlett, Y. Doz and G. Hedlund (Eds.), *Managing the global firm*. London & New York: Routledge.

Other models built around the notion of cross-border innovation are presented in Hedlund, G. (1986). The hypermodern MNC - A heterarchy? *Human Resource Management*, 25 (1), 9-35, and Hedlund, G. (1994). A model of knowledge management and the N-form corporation. *Strategic Management Journal*, 15, 73-90.

^v The model is discussed at length in Sölvell, Ö., Zander, I., 1995, “The Dynamic Multinational Firm”. *International Studies of Management & Organization*. Spring-Summer 1995. Vol. 25, No. 1-2.

^{vi} Home country centered MNCs were common in earlier periods. In John Stopford’s early works one can see clear differences in strategies and structures among MNCs emanating from small versus large home countries. See also Stopford, J.M & Dunning, J.H., 1983, *Multinationals: company performance and global trends*. London : Macmillan.

^{vii} This has been emphasized in several of Michael Porter’s works.

^{viii} The role of identity in firms in general and MNCs in particular has been emphasized by Bruce Kogut and Udo Zander. See Kogut, B. and Zander, U. (1992). Knowledge of the firm, combinative capabilities, and the replication of technology. *Organization Science*, 3 (3), 383-397. And Kogut, B. and Zander, U. (1996). What firms do? Coordination, identity, and learning. *Organization Science*, 7 (5), 502-518.

^{ix} An in-depth study of Swedish MNCs give useful insights. See Arvidsson, N. (1999). *The ignorant MNE – The role of perception gaps in knowledge management*. Published doctoral dissertation. Stockholm: Institute of International Business.

^x The paradox is discussed in Sölvell, Ö. and Zander, I. (1998). International diffusion of knowledge: Isolating mechanisms and the role of the MNE. In A.D. Chandler, P. Hagström and Ö. Sölvell (Eds.), *The Dynamic Firm - The Role of Technology, Strategy, Organization, and Regions*. Oxford University Press.