BREAKING DOWN THE SYNERGY BARRIERS OF THE MNC

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ABSTRACT

The global strategy literature provides a basis for examining strategy, structure, and performance relationships in multinational firms. We develop a framework that examines these relationships and their linkages to the firm’s intangible asset portfolio. Drawing on resource-based theory, this framework suggests that an on-going multinational firm’s worldwide performance is dependent on the fit between its intangible asset portfolio, foreign market entry strategies, partner relationships, and organizational structure. Each of these dimensions can be linked back to the firm’s worldwide strategy and the characteristics of its industry. Implications for research are discussed.

INTRODUCTION

As firms globalize, they face the task of effectively managing a growing asset base distributed across a wide network of subsidiaries worldwide. A major challenge for global managers is to effectively and efficiently manage the firm’s diversified assets and value chain activities across multiple businesses and locations. Firm performance is highly dependent on the global manager’s ability to exploit synergies and create market power across the firm’s diversified portfolio of businesses. We present a dynamic model of global strategy grounded in resource-based theory that integrates the firm’s worldwide asset portfolio with its global strategy and structure. International scholars have focused on how multinationals manage relationships with individual country subsidiaries in light of each subsidiary’s unique strategy and structure requirements. Less attention, however, has focused on how the firm integrates its resources, strategies, and structure across multiple businesses and countries. Our model addresses the need for global managers to clearly integrate their firm’s corporate business strategies and assets in order to achieve worldwide synergies and market power and improve performance. The model we present in this paper suggests a new way for managers and academics to think about how diversified multinationals manage and integrate their worldwide assets.

Studies of global strategy have examined headquarters-subsidiary relationships with an eye on helping global managers more effectively manage corporate headquarters’ relationships with individual country subsidiaries in order to exploit synergies and create market power. Much of the focus of existing studies has been to help firms maximize the effectiveness of individual country subsidiaries. Our objective is to move beyond the narrow focus of headquarters’ relationships with individual country subsidiaries and examine the broader question of how firms create synergies and market power by exploiting relationships across multiple subsidiaries located around the world. The following questions address the additional challenges that global managers face managing the multinational firm in light of greater geographical and product diversification:

- What additional opportunities for exploiting synergies and creating market power are created for multinational firms when they diversify their product offerings across multiple locations?
- How can global managers manage relationships across multiple subsidiaries to maximize competitive advantage?
- How is the industry structure-firm strategy-corporate structure-performance relationship affected when firms diversify worldwide?
What role do the firm’s resources and asset portfolio play in managing these relationships and maximizing firm performance and competitive advantage?

Firm performance varies as a function of synergistic relationships and market power among an industry’s participants. Numerous studies have elaborated on the benefits of diversification based on synergy (Douglas and Lang, 2003; Markides and Williamson, 1996; Wan and Hoskisson, 2003). Product and geographic diversification enables the firm to build and extend its resource base, organizational capabilities, and distinctive competencies in ways that create additional value through greater economies of scale and scope. Diversification into related businesses improves the firm’s competitive position by eliminating competition, creating entry barriers, and enhancing market power. Firms exercise market power through premium pricing and lower supplier costs. Economies of scale and scope and market power are highly related, since increases in firm size are associated with increases in the firm’s relative market power within its industry (Lee and Kwok, 1988).

Scale economies in manufacturing, marketing, raw material purchases, R&D, and other value chain activities are realized when individual units are consolidated, thereby creating synergies (Lee and O’Neill, 2003). Scope economies generate synergies when it is less costly to jointly produce two or more products instead of producing each product separately. In addition, the cross-subsidization of products lowers costs and creates opportunities for enhancing market share through lower pricing. The potential for exploiting synergies, however, is limited by structural and mobility barriers to cost reduction and innovation in the firm’s industry and resource base. Structural barriers include country differences in legal frameworks, political systems, and marketing practices; differences in customer preferences; the existence of labor and network externalities; limitations on the firm’s resources and internal capabilities; and, transportation costs.

The key challenge for global managers is to break down mobility and synergy barriers. We introduce a new framework for understanding the links between the multinational firm’s strategy, structure, resources, and performance. We first introduce the framework by briefing reviewing the importance of global strategy, firm resources, and foreign direct investment to the framework. We then examine the firm’s intangible asset portfolio, the relationship between the firm’s worldwide strategy requirements and its industry structure, the firm’s asset requirements, and the relationship between the firm’s worldwide strategy and organizational structure. Last, we examine synergy and mobility barriers that affect the firm’s market entry strategy, strategy and structure, and worldwide performance.

AN INTEGRATED FRAMEWORK

Three streams of literature have independently examined the effects of global strategy on the multinational firm’s success in international markets. The global strategy literature has produced a good framework for understanding the underlying characteristics of a business, which have a significant effect on the firm’s worldwide strategy and organizational structure. The failure to achieve fit between the firm’s strategy and structure and the strategic requirements of the firm’s industry can have detrimental effects on operational outcomes and firm performance (Roth and Morrison, 1992). Coke and Pepsi, for example, have created strong global brands with worldwide distribution. The structure of the cola industry, however, forces soft drink producers to bottle and distribute their product locally. Namely, it is costly to transport bottled beverages over great distances, consumer tastes differ between regions, and advertising must be locally differentiated. While Coke and Pepsi may prefer to operate using a global strategy, industry structure forces them to operate locally in bottling, packaging, and advertising. In essence, the structure of the cola industry creates synergy barriers for competitors in the soft drink industry. Synergies are limited by the structure of the industry.

In contrast, Texas Instruments spends millions of dollars each year developing new semiconductor technologies for the telecommunications industry. The nature of its business requires heavy R&D outlays to develop new technologies that have short product life cycles. The only way to recover such costs is to distribute products globally to achieve global volume. Global volume is best achieved by selling standardized technologies to global OEMs. The structure of the semiconductor industry structure requires semiconductor firms to adopt global strategies. Locally differentiated strategies, which add to the firm’s cost structure, aren’t feasible given the structure of the worldwide semiconductor industry. In essence, synergy barriers are much lower in the semiconductor industry compared with
Resource-based theory suggests that a firm’s sustainable competitive advantage results from the firm’s ability to generate resources that are valuable, rare, imperfectly imitable, and not substitutable (Barney, 2001). It is these resources that can be linked to sustained competitive advantage and long-term performance. Intel, for example, can develop temporary competitive advantages over competitors by developing microprocessors that are faster and more efficient. As long as its microprocessors are the fastest and most efficient on the market, it can charge a premium. Such competitive advantages, however, are temporary, since competing firms inevitably produce their own products with equal or superior product attributes. Temporary competitive advantages, therefore, are irrelevant over the long-term. What is important is Intel’s ability to sustain its worldwide competitive advantage by developing advanced microprocessor technologies ahead of its competition not once, but again and again, into perpetuity. Intangible assets are more difficult to appropriate than physical or tangible assets. Therefore, the firm’s intangible asset portfolio plays an important role in enabling firms to overcome synergy and mobility barriers and to establish long-term competitive advantage.

The literature on foreign direct investment provides a theoretical basis for understanding the linkage between firm-specific advantages and the firm’s mode of entry into foreign markets. How does a U.S. company like Proctor & Gamble, for example, compete against a German firm like Henkel in the German market? Before P&G entered the German market, it operated with a liability of foreignness — it had little knowledge of German language, culture, laws, business and market practices, or customs. This liability could only be overcome by either selling products at a lower price or by offering German consumers product attributes that Henkel could not offer (Hymer, 1976). Foreign investment, therefore, was a necessary condition for long-term success in the German market. Exporting neither protected P&G’s intangible assets from appropriation nor firmly rooted P&G in the German culture. P&G overcame its liability of foreignness by establishing a Germany subsidiary that channeled P&G products into and effectively differentiated them for the German market. P&G is so firmly rooted in Germany today that German consumers unfamiliar with P&G’s origins might suspect that P&G is a German company.

Despite the significant contributions that these literature streams have made to our understanding of global strategy, little effort has been made to synthesize the literature in a framework that identifies linkages across these different streams. We address this gap in the literature in this paper. We propose a new framework that identifies strategy dimensions of interest to the global manager, states the primary assumptions of the underlying framework, and draws relationships among the different elements of the framework. The literature in global strategy has primarily approached these strategy dimensions by examining relationships between the corporate parent and individual subsidiaries as though they existed in isolation from other businesses within the firm’s product portfolio and in isolation from other subsidiaries in the firm’s worldwide subsidiary network. One of the primary benefits of the diversified, multinational firm, however, is its ability to create value by managing and transferring assets across multiple businesses and locations. Thus, a primary objective of our framework is to focus on how multinational firms transfer and differentiate their assets across multiple locations and how multinationals integrate their worldwide resources across different businesses.

Our framework is presented in Figure 1. The global manager’s first task in global strategy making is to understand the underlying characteristics of the business, since it is these characteristics that determine the firm’s worldwide strategic requirements. We use the term “strategic requirements” in lieu of “strategy,” because in some cases executives choose to pursue strategies that do not fit the strategic requirements of their industry, even though the structure of the industry may prescribe certain strategic responses. Competition in cement, for example, is based primarily on price, since cement is difficult to differentiate. As a result, large cement producers like Lafarge, Hanson, and Boral are able to apply common policies and product standards to their overseas subsidiaries as a means of maximizing product efficiency and quality. In large markets such as the United States, a large portion of cement production is located near the final customer in order to lower transportation costs. Local production is also used in smaller markets like Malaysia where imported cement is subject to high import tariffs. The ability to produce locally, however, is limited by the need to produce close to coal and oil sources. As a result, some markets are served with exports when transportation costs are more than offset by lower costs from producing near coal and oil reserves. Thus, it is the nature of the product (i.e., standardized), location of input goods (i.e., coal and oil), and cost of
transporting the final product to the customer (i.e., high) that determines where cement producers locate production and how they manage their overseas subsidiaries.

Existing research links industry structure and the firm’s worldwide strategy directly to organizational structure, strategy implementation, and performance without considering intermediate linkages. In our model, however, the firm’s asset portfolio requirements are a critical intermediate linkage between the firm’s worldwide strategic requirements and its foreign market entry strategy and foreign partner relationships. International business scholars view the firm’s assets, especially intangible ones, as the primary means by which it overcomes its inherent disadvantage of foreignness when competing in foreign markets (Buckley and Casson, 1976; Caves, 1971; Coase, 1937; Dunning, 1973; Hennart, 1982; Rugman, 1981; Williamson, 1975). Firms overcome their inherent disadvantage of competing with local firms in their own markets by developing low cost positions in their industry or differentiating product attributes from competitors through firm-specific advantages. Firms develop competitive advantages primarily by creating intangible assets that are unique and cannot be easily imitated or substituted by local firms. Japanese semiconductor firms such as Fujitsu and Hitachi, for example, compete in the United States on the basis of low price that is made possible by superior low cost manufacturing processes. Michelin, in contrast, competes by charging price premiums made possible through its brand image and perceived superior radial technology.

An important distinction can be made between the firm’s asset portfolio requirements and actual asset portfolio. The structure of the firm’s businesses implies a set of strategic alternatives. A major strategic issue in a global business is to identify those assets that lead to a sustained competitive advantage in foreign markets. The firm’s actual asset portfolio reflects both assets accumulated through past strategic actions and assets created in response to changing environmental conditions. The firm’s asset portfolio, then, drives the firm’s choice of mode of entry into foreign markets, which in turn defines the firm’s relationships with foreign partners. Foreign market entry strategies and foreign partner relationships are influenced by both the firm’s existing asset base and assets required by evolving structural characteristics of the industry. These strategies are further affected by the firm’s headquarters-subsidiary relationships and worldwide organizational structure. The gap between the firm’s actual asset portfolio and the asset portfolio required by the structure of its business constrains its international strategy. To remove this constraint, the firm needs to adjust its asset portfolio, a process which is slowed by existing synergy barriers in both the firm and the firm’s industry.

The framework presented in Figure 1 presents the case of a single business firm. When a firm is active in several businesses, however, the dynamic adjustment of the firm’s asset portfolio occurs through the transfer of assets between geographic locations as well as between businesses. This is shown graphically in Figure 2. In order to identify how firms break down synergy barriers and more effectively transfer assets across different businesses and geographical locations, we need to better understand the nature of these assets and their potential for transfer. We discuss these issues in the following section.

THE FIRM’S INTANGIBLE ASSET PORTFOLIO

Resource-based theory suggests that firms create sustainable competitive advantages by developing a unique set of resources and organizational capabilities that are valuable, rare, imperfectly imitable, and non-substitutable (Amit and Shoemaker, 1993; Barney, 1991; Fahy, 2002; Grant, 1993; Mahoney and Pandian, 1992; Peng, 2001; Teece and Shuen, 1997). A variety of tangible resources, intangible assets, and skills can be exploited to create firm competencies. Sustainable competitive advantage, however, requires that the condition of heterogeneity or differentiation among firms be preserved. While some tangible assets may create temporary competitive advantages, such advantages are unlikely to be sustained, since tangible assets may be bought and sold in market transactions at prices equal to their economic value. Only intangible assets can be linked to sustained competitive advantage.

Intangible assets are resources that are non-physical such as the intellectual property rights of patents, trademarks, copyrights and registered designs, contracts and licenses, trade secrets, public knowledge such as published scientific works, personal and organizational networks, and organizational culture and the reputation of the firm and its products (Hall, 1993, 1992; Itami and Roehl, 1987). In order to achieve a sustained global competitive advantage, it is necessary for the firm to build intangible assets that can be leveraged in multiple countries and across multiple businesses. It is the firm’s ability to transfer its intangible assets from country to country that leads to a
global competitive advantage. Intangible assets such as technology, marketing capabilities, and strong brand names can be transferred to multiple countries at relatively low cost. Such a strategy helps the firm overcome its disadvantages when operating in foreign markets, since local companies cannot easily or cheaply acquire or duplicate these advantages. Transferring intangible assets across businesses is also a source of synergy. All intangible assets, however, are not always easy to transfer abroad or across businesses.

Intangible Assets, Their Transferability, and Their Need for Differentiation

We view intangible assets as best measured along two distinct dimensions: the degree to which a firm is able to transfer them to other countries or businesses and the need for local differentiation from country to country or business to business (Furrer, Sudharshan and Thomas, 2001). The degree of transferability can be defined as the extent to which an intangible asset can be successfully transferred from one location to another. Some intangible assets, such as in-depth knowledge of a particular overseas market, are location-specific and cannot easily be transferred to other markets. In addition, intangible assets such as tacit knowledge are difficult to transfer because most tacit knowledge is only acquired through a pain-staking and time-consuming process (Barney, 1999). Consequently, tacit knowledge is one form of knowhow that is difficult to transfer. In contrast, intangible assets like the intellectual property rights of patents and trademarks can easily and quickly be transferred almost anywhere. The need for differentiation can be defined as the extent to which the value of an intangible asset diminishes when it is transferred to other markets without adaptation or modification. Many intangible assets such as marketing expertise, skills, and strong domestic brands are location-specific and must be adapted to local market conditions in order to preserve their value. In contrast, production processes may require little adaptation when product technology is standardized.

In Figure 3, we contrast the two dimensions of degree of transferability and need for differentiation and show four distinct intangible asset forms based on these two dimensions. First, local intangible assets, shown in the lower right-hand quadrant, are difficult to transfer and must be adapted in each location where they are deployed. These intangible assets, for example knowledge of marketing practices and distribution channels, are location-specific insofar as they must be developed for each market where the firm operates. Second, mobile intangible assets, shown in the upper left-hand quadrant, are easily transferred from one market to another and require little adaptation. Such assets are highly standardized. As a result, they are easy to transfer and require no differentiation from one location to another.

Third, portable intangible assets, shown in the upper right-hand quadrant, can easily be transferred, but they must be adapted to local conditions. A successful global brand is a good example of a portable intangible asset, since it is easily transferable abroad but often needs to be adapted to the cultural attributes of the local market. Last, sticky intangible assets, shown in the lower left-hand quadrant, are difficult to transfer, even though they are standardized worldwide. A firm’s organizational culture, its reputation among customers and suppliers, and its perceived trustworthiness are examples of socially complex intangible assets. Therefore, they are difficult to transfer to foreign markets. Even in cases where these intangible assets are modified and adapted to the foreign market, it takes time to develop these forms of intangible assets in each local market. An example is Federal Express, which has developed a unique set of capabilities and strong reputation for express delivery service in the United States. Its attempts, however, to expand outside of the U.S. market have largely failed because non-U.S. consumers have been slow to accept the Fedex brand, especially in Europe where DHL has already established a strong reputation.

Worldwide Strategic Requirements and Industry Structure

Firms should design worldwide strategies in response to industry conditions and structure. In particular, their strategies should fit their industry’s demands for global efficiency and local responsiveness. Some industries require low levels of global efficiency while others require high levels of efficiency. Some industries require high levels of local responsiveness while others have low requirements. The food, beverage, household appliance, banking, insurance, and healthcare industries, for example, generally require higher levels of local responsiveness or differentiation and lower levels of global efficiency or integration than other industries. Strong local competitors exist in most markets, which forces foreign firms to establish long-term positions in local markets as a basis for overcoming their liabilities of foreignness.

Strong government regulations in industries such as banking and healthcare, high transportation costs in industries such as beverages and white goods, and cultural differences, represent significant barriers to globalization.
They force firms to locate assets locally and prevent firms from shifting value chain activities worldwide to achieve greater synergies and global efficiency. Thus, firms operating in industries that require a high degree of local responsiveness need to design strategies that are highly customized for each market in which they compete (Doz, 1986; Prahalad and Doz, 1987; Harzing, 2000; Johnson, 1995; Roth and Morrison, 1992; Taggart, 1997). Competitive advantages are created using firm-specific capabilities to differentiate the firm’s products to match local demands. Customized strategies, however, are costly in that they duplicate value chain activities in multiple markets. Such strategies prevent firms from competing using low cost strategies and make it difficult to achieve economies of scale and scope effects through large-scale production.

In contrast to multinational or multi-domestic industries, global industries such as semiconductors, non-ferrous metals, and electronics require high levels of global efficiency and low levels of local responsiveness. High product development costs and short product life cycles make it necessary for firms to sell their product globally in order to cover the high cost of bringing new products to market. The existence of strong global competitors with global volume makes it difficult for domestic firms with lower volumes to survive within this industry structure. Most domestic firms are forced to become global as a survival mechanism. Highly standardized product technologies and worldwide brand awareness make it possible for firms to sell standardized products to meet standardized worldwide needs. This reduces the need for local adaptation and differentiation. When transportation costs are low relative to the product’s overall value, firms can lower per unit costs by producing in more efficient, large-scale plants.

This strategic response to industry conditions maximizes product reliability and efficiency and lowers per unit costs through economies of scale and scope effects. The existence of multiple, specialized plants located in multiple countries leads to an increased flow of components, product, technology, and people across national boundaries (Kobrin, 1991). This requires tight coordination of resource flows and the integration of value chain activities. Thus, global strategies create linkages and interdependencies among the firm’s worldwide units and these linkages create opportunities to develop internal learning capabilities that help the firm innovate and effectively respond to competitive pressures in their environment. In contrast to global industries, transnational industries such as automobiles, pharmaceuticals, and telecommunications face pressures to maximize both global efficiency and local knowledge. Firms competing in industries with these simultaneous pressures design strategies that are both locally responsive and globally integrated (Bartlett and Ghoshal, 1989; Ghoshal and Nohria, 1993; Nohria and Ghoshal, 1994; Roth and Morrison, 1992; Roth and O’Donnell, 1996).

The Firm’s Asset Portfolio Requirements

While the firm’s worldwide strategy and structure are related, an important intermediate linkage exists between strategy and structure that explains how international firms create and sustain worldwide competitive advantage – its asset portfolio requirements. The firm’s strategic response to industry structure, rather than directly determining its worldwide structure, more directly determines the types of assets the firm should use to compete in foreign markets. It is the nature of these assets, both tangible and intangible, that determines how firms should compete in foreign markets and, ultimately, how firms should deploy, structure, and coordinate their assets worldwide. Thus, while strategy and structure are strongly related, we believe this relationship is best understood by examining the firm’s asset portfolio requirements as an intermediate linkage between strategy and structure.

The literature in global strategy stresses the importance of achieving a fit between industry structure, strategy, and structure as a means of maximizing worldwide performance. Multinational industries, for example, require a differentiated strategic response to industry conditions and a worldwide structure based on the duplication of value chain activities across locations. Global industries, in contrast, require a standardized strategic response to industry conditions and a worldwide structure based on the standardization and specialization of assets that leads to heavy coordination of resource flows across multiple locations. In this view, firms create worldwide competitive advantage by organizing their worldwide assets in ways that match the firm’s strategic response to industry conditions. In our view, however, a critical missing element is the firm’s asset portfolio. We believe that the firm’s strategic response to industry conditions directly affects the nature of the assets the firm will use to compete in foreign markets. These assets determine the firm’s appropriate foreign market entry strategy and, ultimately, how the firm organizes and coordinates its assets worldwide. We emphasize the importance of the firm’s asset portfolio as the source of the firm’s sustainable worldwide competitive advantage. The firm’s asset portfolio requirements represent a critical
intermediate link between the firm’s strategy, or strategic response to industry conditions, and the firm’s foreign market entry strategy and worldwide structure. In the following section, we discuss these relationships as they relate to the resource-based view of the firm.

The Resource-Based View and Its Link to Strategy, Structure, and Performance

Based on the influence of the firm’s worldwide industry structure, the firm’s worldwide strategic requirements and asset portfolio requirements should be aligned. For example, firms that strive for a sustained competitive advantage in industries that require a high degree of local knowledge and a low degree of global efficiency require asset portfolios that are dominated by local intangible assets. These location-specific assets are differentiated from country to country and are, as a result, difficult to transfer. Firms that strive for a sustained competitive advantage in industries that require a low degree of local knowledge and high degree of global efficiency require asset portfolios that are dominated by mobile intangible assets that are easily transferred overseas without transformation. The firm’s global strategy is based on global-scale facilities producing standardized products shipped worldwide under a tightly controlled and centralized organization. This configuration is based on the centralization of assets, resources, and responsibilities. Overseas subsidiaries are used to reach foreign markets as a means of building global scale. The role of overseas subsidiaries is limited primarily to sales and service activities, although local assembly plants may be dictated by economic or political pressures.

Firms that operate in transnational industries and use a simultaneous strategic response to the pressures of global efficiency and local knowledge require portable intangible assets that can be easily transferred abroad and are adapted to the specific needs of the local market. Transnational strategies require firms to seek efficiency not for its own sake but as a means of achieving global competitiveness. The firm acknowledges the importance of local knowledge as a tool for achieving flexibility in its global operations. Innovations are regarded as an outcome of a larger process of organizational learning that encompasses each unit in the firm’s global operations. In order to successfully implement such a strategy, the firm develops a portfolio of portable intangible assets that are both transferable and capable of being differentiated that meet the needs of each market. Last, firms that operate in national industries pursue strategies that are neither globally integrated nor locally responsive, the result of sticky intangible assets that are neither mobile nor adaptable. Firms with sticky intangible assets participate in foreign markets primarily by developing technology and assets for the domestic market and then exporting them overseas with little adaptation or modification. National strategies are often viewed as export strategies insofar as the primary flow of products, technology, and experience moves from the firm’s headquarters to its overseas subsidiaries, which have little latitude to adapt products, technologies, or strategies for the local market.

STRATEGY AND ORGANIZATIONAL STRUCTURE

If industry structure affects how firms formulate worldwide strategy, then does the firm’s worldwide strategy affect the structure of its worldwide operations? Existing studies suggest that is does. Two primary structural issues have been addressed in the literature: (1) organizational design and (2) headquarters–subsidiary relationships. Firms maximize performance when they correctly align their strategy and structure. Structure follows strategy because structure helps the firm effectively implement its chosen strategy (Chandler and Daems, 1980). The firm must, therefore, readjust its structure over time as its strategy evolves. Firms with a low level of foreign sales, for example, often manage international sales using an international division, which helps the firm focus and develop its international resources and talent. As foreign sales increase, however, it becomes increasingly difficult for the firm to manage greater geographic and product diversity within a single division. Firms are, therefore, likely to abandon this structure as they become more internationally diversified. Undiversified firms that sell a product or service in a diverse set of geographic locations can more effectively manage geographical diversity by adopting geographical structures, with individual subsidiaries managing sales in specific locations. Diversified firms that sell a wide range of products can more effectively manage foreign product diversity using worldwide product divisions, with individual divisions managing the worldwide sales of related product areas (Daniels, 1985; Daniels, Pitts and Tretter, 1984; Egelhoff, 1988, 1982; Fouraker and Stopford, 1968; Stopford and Wells, 1972).

During the 1980s, Texas Instruments (TI) managed its high level of product diversity using worldwide product divisions for its computer, calculator, and semiconductor businesses. In Europe, TI developed and manufactured semiconductor technologies through subsidiaries in England, France, Germany, and Italy. European sales were managed through TI’s French subsidiary, which reported directly to TI’s semiconductor headquarters in Dallas. An
exception to TI’s worldwide product division structure was Latin America. TI managed its semiconductor, computer, and calculator sales to Latin America through a separate Latin America division. TI believed that a separate division was necessary to manage the economic and political instability that characterized the region at that time. Computer sales were distributed through TI distributorships. TI’s primary customers were government entities as few individual consumers could afford personal computers. During this period, Latin America was characterized by a myriad of foreign exchange rate regulations and foreign currency controls. A separate Latin America division enabled TI to focus its Latin American talent and attention on managing its complex government and distributorship relationships. As Latin America stabilized during the late 1980s, and computer sales shifted from government to consumer buyers, it became difficult to justify the high cost of managing geographic and product diversity in a single division. TI eventually closed its Latin America division and shifted responsibility for its Latin American computer, calculator, and semiconductor sales back to its worldwide product divisions. Each division was able to more efficiently manage sales within their respective product areas.

In addition to organizational design issues, appropriate administrative systems and capabilities are necessary for implementing the firm’s worldwide strategies. Globalization increases the number and complexity of relationships and activities that the firm must manage across its worldwide subsidiary network. The way in which the firm manages worldwide resource flows becomes a source of the firm’s competitive advantage. That is, better coordination of the firm’s worldwide resource flows compared to industry competitors creates competitive advantage. Global strategies, because they lead to standardization of value chain activities within the firm, require more extensive coordination of manufacturing operations, raw materials purchasing, research and development, accounting systems, government and public relations, human resource management policies, distribution, promotion, advertising, management information systems, and other value chain activities. Multi-domestic strategies, because they lead to customization of strategies from one country to another, require less coordination within the same business unit (Porter, 1986).

Global coordination is improved when the firm develops what Roth, Schweiger and Morrison called a “shared managerial philosophy”: common beliefs, values, and ways of looking at things and managing people that makes it easier for the firm to spread its systems and policies throughout the organization (1991). Coordination is enhanced when the firm promotes a shared managerial philosophy through greater personal contacts among managers, management transfers across the firm’s different businesses and locations, and integrative mechanisms such as task forces, committees, and liaison personnel that improve coordination across different units.

BREAKING DOWN SYNERGY BARRIERS

The framework presented in Figures 1 and 2 help us better understand how synergy and mobility barriers can be broken down through the transfer of appropriate sets of intangible resources abroad and adaptation of specific intangible assets to meet location business conditions. In the next section, we focus on two strategic decisions that benefit from this framework: the foreign market entry decision and the firm’s worldwide corporate structure.

Foreign Market Entry Strategy

In a global context, successful strategies depend on the fit between the firm’s asset portfolio and foreign market entry strategy, relationships with foreign partners, and the firm’s worldwide structure. Our understanding of the relationship between the firm’s intangible asset portfolio and foreign market entry strategy comes primarily from our understanding of the foreign direct investment behavior of internationalizing firms. Firms that establish overseas production capabilities generally face three primary questions: (1) how does the firm overcome the disadvantages of competing against national firms in their own marketplace?, (2) what is the best means by which the firm delivers its products to the local marketplace?, and (3) what location-specific advantages are associated with locating the firm’s value chain activities in one location versus another?

Questions one and two are related to the firm’s asset portfolio requirements. Successful foreign direct investment in this context rests on two important assumptions. First, the firm must possess firm-specific knowledge and expertise that forms the basis of the firm’s competitive advantage. The firm then uses its firm-specific knowledge to differentiate product attributes from local competitors or to lower its cost structure. In strategic terms, it is the firm’s intangible assets that support the firm’s differentiation or low cost strategies in foreign markets. It is through these two strategies that the firm is able to overcome its “liability of foreignness.” Second, firm profitability is
maximized when the firm invests in local production under its control. The firm minimizes political risk by investing in intangible assets in the form of firm-specific knowledge, technology, and expertise.

Intangible assets are rooted in the firm’s technical capabilities, employee knowledge, and organizational structure and are more difficult to appropriate by foreign entities than tangible assets. In addition, the firm minimizes potential appropriation of intangible assets by investing in wholly-owned subsidiaries under its direct control. Other market entry strategies such as exporting, licensing, production agreements, and joint ventures are less desirable market entry options because they expose the firm’s intangible asset portfolio to possible appropriation by other firms. Ultimately, the cost of building direct, internal relationships with end users through local production is lower than the cost of organizing markets outside of the firm’s control. Thus, internalization of markets is viewed as the best strategy for guarding against the loss of knowledge because knowledge is shielded from third party contacts that occur when the firm exports its product or produces it in cooperation with other firms.

The firm’s choice between a wholly owned subsidiary (i.e., startup or greenfield investment), acquisition of a local firm, or joint venture depends on the nature of the firm’s intangible asset portfolio. Firms use wholly owned subsidiaries as a means of protecting assets when their competitive advantage is based on intangible assets. Wholly owned subsidiaries are also an efficient means of gaining access to location-specific assets such as suppliers, labor, and distribution channels at a relative low cost using market transactions and contracts (Hennart, 1988). In contrast, acquisitions are preferable when local firms possess location-specific assets that are difficult to duplicate. For example, acquisitions are an effective means of gaining access to a local company’s reputation, strong domestic brands, distribution channels, supplier relationships, and market share. The latter is particularly important in highly saturated industries, in which case firms prefer to acquire existing manufacturing capacity rather than add to an already overbuilt manufacturing capacity.

Joint ventures and strategic alliances increase the risk that the firm’s knowledge base and systems will be lost or compromised. As a result, firms with strong competitive advantages based on intangible assets such as internal knowledge and capabilities are unlikely to enter foreign markets using these arrangements. They are more likely to engage in acquisitions or to build new facilities that limit their intangible assets from exposure to outside parties and possible appropriation. Joint venture agreements are well-suited in cases where the firm’s objective is to gain access to new markets, obtain new skills, or share risks and resources. Despite these benefits, joint ventures and strategic alliances have high failure rates and relatively short life spans. One reason is that one partner invariably quickly appropriates the intangible assets (i.e., knowledge) of the other partner without a concurrent sharing of its own intangible assets. The domination of one partner eventually precipitates the breakup of the venture. Firms are, therefore, most likely to use joint ventures when their primary contribution to the venture is based on tangible assets and when their overall objective for entering the venture is to gain access to the intangible assets of the partner. In instances where the firm does possess intangible assets, it will enter into such arrangements only when its intangible assets are sticky in the sense that they are difficult to transfer to the joint venture partner. Otherwise, the firm will internalize its transactions through acquisitions and greenfield investments (Das and Teng, 2000).

Worldwide Corporate Structure

The firm’s worldwide structure has traditionally been viewed as a direct response to the firm’s worldwide strategy. That is, organizational structure follows firm strategy. Different strategies require different structures, and each structure demands a well-defined relationship between the firm’s headquarters and worldwide subsidiaries. Global strategies, for example, require heavy integration (e.g., standardized technology, product, and manufacturing processes and specialized, large-scale production). As a result, they require tight coordination of resource flows between headquarters and subsidiaries. Subsidiaries specialize in the large-scale production of single components that are shipped to other subsidiaries for additional value creation, then to other subsidiaries for final assembly and distribution to the customer. Therefore, the activities of one subsidiary have a significant effect on the activities of other subsidiaries. Consequently, headquarters must play a strong centralized role in controlling shipments, as well as the flow of other resources like personnel, foreign exchange, and cash flow among its subsidiaries.

Firms that heavily integrate their worldwide operations make more extensive use of coordination mechanisms to control resource flows across their subsidiary network. These coordination mechanisms can be formal or subtle, with formal mechanisms normally preceding subtle mechanisms insofar as they are generally easier to implement (Roth, Schweiger and Morrison, 1991). Examples of formal mechanisms include greater centralization of decision
making, formalization of decision making practices, planning in financial reporting and budgeting, output control using records and reports to evaluate individual subsidiaries, and behavioral control through frequent visits of personnel between headquarters and the firm’s subsidiaries. Subtle mechanisms are more difficult to implement because they are embedded in the company’s organization culture. Firms that use multi-domestic strategies use these formal and subtle mechanisms less frequently, since it is the ability of each subsidiary to serve each local market according to its individual needs that defines the multi-domestic firm’s overseas success. Decision-making in multi-domestic firms is, therefore, generally decentralized. In addition, planning, budgeting, and company policies are determined by the individual subsidiary, which manages its own personnel without significant monitoring or control from the parent company.

These strategy-structure linkages are best understood by examining the role of intangible assets and the firm’s entry mode strategy on the strategy-structure linkage. In our view, it is the firm’s asset portfolio that flows from the firm’s strategy. In turn, the firm’s asset portfolio determines the firm’s entry market strategy, which determines the firm’s ideal organizational forms. The ideal worldwide organizational form depends on the types of intangible assets that dominate the firm’s portfolio (Furrer, Sudharshan and Thomas, 2001). For example, firms that compete in locally responsive industries using multi-domestic strategies have intangible asset portfolios that are dominated by local assets. For the multi-domestic firm, competitive advantage is a function of its ability to develop customized responses to market needs that cannot be easily imitated by competitors. These customized responses may be reflected in special product attributes or unique approaches to distribution, marketing, and sales that are built on specialized knowledge and expertise. The duplication of value chain activities in each market raises the firm’s worldwide cost structure but it also ensures the greatest control over value chain activities. In addition, it enables each subsidiary to quickly adapt value chain activities to changing local market needs. The corporate parent’s role is limited to the allocation of resources among competing units and its major contribution to each local subsidiary is in the form of tangible rather than intangible assets. For the multi-domestic firm, strategic alliances are an important strategy for gaining access to local knowledge and expertise.

In global industries, firms have intangible asset portfolios that are dominated by mobile assets such as standardized products and manufacturing processes. They can be easily and quickly transferred from one market to another. The parent company provides strategic direction and contributes valuable intangible assets to its worldwide subsidiaries, whose primary responsibility is to implement parent company directives with little local adaptation. When firms transfer intangible assets from market to market, they subject assets to possible appropriation from competitors and outside parties. Therefore, firms that use mobile intangible assets to penetrate foreign markets transfer their assets internally (e.g., wholly owned subsidiary) rather than through another entry form that exposes the firm’s assets to possible appropriation (e.g., joint ventures, strategic alliances, or production agreements).

Firms that compete in national industries have asset portfolios dominated by sticky assets that are developed primarily for the domestic market. Internationalization is often pursued as an after-thought or as a means of utilizing excess capacity. The firm’s intangible assets are transferred to foreign markets without significant modification. Like global industries, intangible assets flow from the corporate parent to the firm’s worldwide subsidiaries, whose responsibility is to leverage and build parent company competencies. Unlike global companies, however, the firm’s assets have only minor worldwide appeal insofar as they are developed primarily for the domestic market. In contrast, firms that compete in transnational industries have asset portfolios that are dominated by portable intangible assets. Knowledge is jointly developed between the corporate parent and its subsidiaries and this knowledge is jointly shared worldwide. Thus, intangible assets flow from the corporate parent to its subsidiaries, which in turn individually develop intangible assets that are transferred back to the corporate parent or to other subsidiaries. Such a strategy leads to a combination of entry strategies. Internal entry strategies such as wholly owned subsidiaries are used as a means of transferring intangible assets when possible appropriation exists. External entry strategies such as joint ventures and strategic alliances are used as a means of acquiring and developing additional intangible resources.

**CONCLUSION**

Our objective in this paper was to focus managers’ attention on the need to think differently about their firm’s intangible assets. Our Worldwide Strategy Framework gives managers another way to view the traditional strategy-structure-performance relationship. Industry structure determines the firm’s strategic requirements but it is the determination of the firm’s intangible portfolio requirements that is the real challenge in strategy making, since the
firm’s intangible assets ultimately define the firm’s competitive advantage. They also determine the firm’s preferred mode of entry into foreign markets, its relationships with foreign partners, and its ideal organizational structure. In describing these strategy relationships, we focused on relating the existing work on global strategy and international business to the resource-based theory of competitive advantage.

In constructing the firm’s intangible asset portfolio, managers must consider three issues: (1) the intangible asset portfolio requirements of their industry, (2) the degree to which these assets are transferable overseas, and (3) the need to adapt these assets to the individual needs of each market. Domestic chocolate manufacturers in Brazil, for example, compete on the basis of local knowledge and local intangible assets but must defend against in-roads by globally efficient firms like Nestlé and Jacobs Suchard. It is ultimately the local Brazilian firm’s success in creating local knowledge that is valued by Brazilian consumers and cannot be easily duplicated by more globally efficient firms that determines the sustainability of their competitive advantage. Firms that compete on the basis of global efficiency and mobile assets, in contrast, benefit by transferring mobile assets to multiple markets and achieving global volume. The global firm’s primary objective is to overcome advantages created by local firms with local knowledge. Global firms ultimately overcome these disadvantages by differentiating their intangible assets in ways that appeal to local consumers or by offering a global product at a competitive price. In the end, it is the firm’s ability to create, transfer, and differentiate its intangible assets that determines its long-term performance and global competitive advantage.

REFERENCES


Figure 1. Worldwide Business Strategy: An Integrated Framework
Figure 2. Worldwide Corporate Strategy
Figure 3. Intangible Asset Portfolio

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<tr>
<th>Degree of Transferability</th>
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