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# UNIT 4 STRUCTURAL DESIGN OF MNEs

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## Objectives

After reading this unit, you should be able to:

- identify the organisational structure and its position in evolution,
- understand the managerial orientation,
- understand the evolutionary changes of MNE structure of the U.S., Japan and Europe, and
- identify the appropriate structure of MNE in its stages of development.

## Structure

- 4.1 Introduction
- 4.2 Pattern of Evolution
- 4.3 Managerial Attitudes and Structure
- 4.4 American MNEs
- 4.5 Japanese MNEs
- 4.6 European MNEs
- 4.7 Organisation of ABB
- 4.8 Designing Appropriate Structure
- 4.9 Summary
- 4.10 Key Words
- 4.11 Self-assessment Questions
- 4.12 Further Readings

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## 4.1 INTRODUCTION

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This unit gives a generalised pattern of organisational evolution of MNEs. As we discussed in the previous block, the changes in structure occur due to the changes in an MNE's commitment to international business and to the needs for integration with domestic business. The structures can vary from a simple export department to a transnational matrix. In fact, changes in structure take place concurrently with changes in managerial attitudes. The Unit gives an account of the transformation that has taken place in the organisation structures of MNEs originating from U.S., Japan and Europe. An illustrative status of recent restructuring of ABB is given. Thereafter the unit proceeds to a discussion of general classification of structure on the basis of function, products, area or a combination of two or more bases.

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## 4.2 PATTERN OF EVOLUTION

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There are two related processes involved in the growth of a domestic firm to an international one. These are: geographic dispersion of corporate resources and corresponding changes in organisational development. One can classify the evolutionary pattern of MNEs from purely domestic company to a transnational corporation into five types. The organisation structure and characteristics of these types are given in Table 4.1.



Table-4.1

Evolution of International Business and Organisational Structure

Types	Structure	Diversification	Characteristics
A) Domestic	Export within the Marketing Deptt.	Minimum	Product/market diversification minimum initial exports, trade, loose formal relationship, no specialized effort
B) Export	Export Deptt. as a separate entity	Low	Early foreign product stages and specialized effort, exports become more important, more formal relationship
C) International	International Division	Low	Export bias eliminated and foreign market entry by any strategy, licensing and FDI abroad, mature stage of a few products, standardisation of products and processes, increased formalised relationships
D) Multinational	World-wide Product/Area based structure	Medium	Growth through diversification, increased international investment, greater formalisation
E) Transnational	Matrix/grid type Structure	High	Substantial increase in foreign investments, widespread and diversified international business (globalisation of business), increased formalisation and greater number of executive incharges.

A company gets into foreign markets by starting export sales to other countries. The growth in international business evolves from the export department to the international division, world wide product, or mixed matrix structures. Chandler's thesis of "structure follows strategy" can be explained in terms of the pattern of evolution of multinational business organisation. It is the strategy of an MNE, which determines the structural design of the organisation by enabling it to achieve its objectives. We shall now discuss different types of organisational structures as shown in Fig. 4.1A and Fig. 4.1B.

Type A: Domestic Oriented Firm

Fig. 4.1A: Organisation of Domestic Oriented Firm (Narrow-product line)

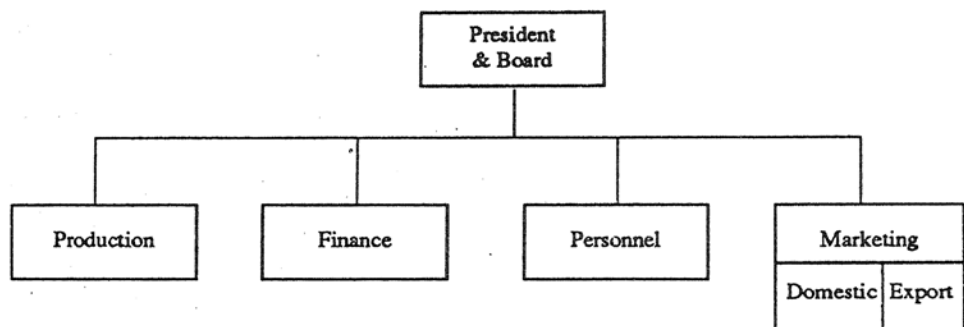
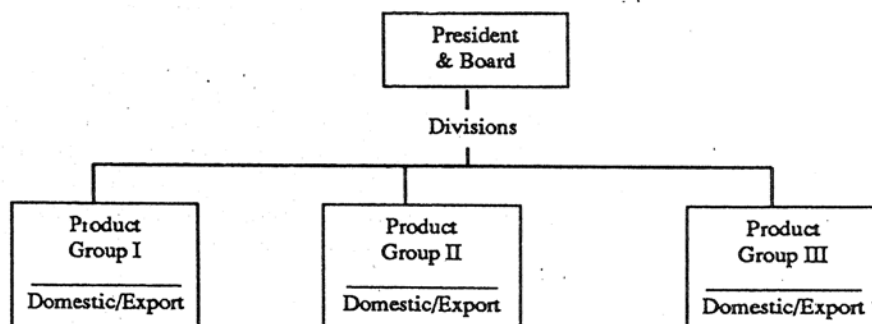


Fig. 4.1B: Wide Product Line





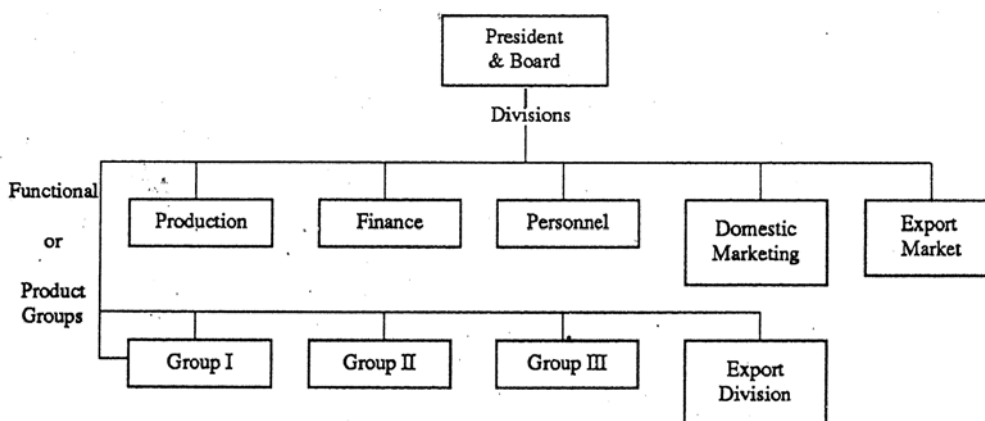
Type-A **domestic oriented** firm can either be organised on functional basis or product group basis. The former is more prevalent when the firm has a narrow product range. Most of the overseas sales occur due to unsolicited orders. As the orders are small in relation to domestic market, the marketing department/division will look after both domestic sales and exports. (Figure 4.1A). All sales, whether domestic and export, are looked after by the marketing manager. However, separate supervisors may be appointed to take care of domestic or export sales.

In cases where the firm has a wider product line, it might have organised on the basis of product groups. Each product group division will have all the functional departments. In such a situation, the exports from each product group may be small compared to the domestic market. In such a situation, each group handles exports separately. As exports are small, the firm does not need to move corporate resources to fully exploit the foreign markets (Figure 4.1B).

As exports start increasing in proportion to its total sales, the company may think of having a separate export department with the necessary specialists to facilitate the exploitation of foreign markets. The export effort gets centralised in the corporation and a separate is set up. This is shown in Figure 4.2. The firm may be organised on functional or on product group basis. As the export profit may be more than the domestic, the corporation tries to shift from the staff function of the export department to the line functions in its overseas activities.

### Type B: Export Oriented Firm

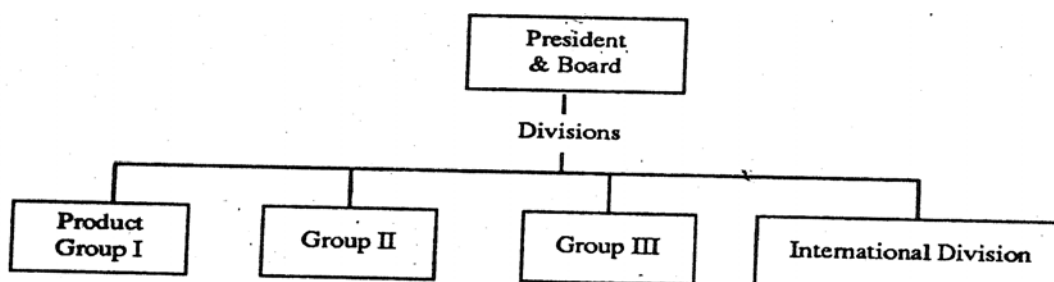
Fig. 4.2: Organisation of Export Oriented Firm



Type-B organisation creates tension when the product division is unable to meet the export orders. The firm may also realise- that the exports are not necessarily the only means of entry into the foreign markets. The optimum entry may be found in some other alternatives, like licensing or direct investments. Such decisions may require a kind of search, which is free from functional or geographic bias. At that time, the firm moves to establish a full-fledged **international division** as against just an export department (see Figure 4.3).

### Type C: International Oriented Firm

Fig. 4.3: Organisation of International Firm





Subsidiaries in several companies may be set up. The international division coordinates all overseas operations (subsidiaries businesses, franchises, gov't. ventures. etc.) of the company. The subsidiaries in foreign countries are often organised by regions which report to the international division. The importance of international division lies in the fact that it provides a base or "umbrella" for the international operations of the company. The working of the subsidiaries abroad is balanced in a manner so that optimum yields are achieved. This form may help an NINE to allocate resources or make investment worldwide.

The international division type of structure may sometimes create frictions between domestic and international divisions, such as divided loyalties, completion in attracting competent operating personnel, etc. The international division, in course of time, may get isolated from other segments of the corporate headquarters. It may become an organisation in itself. Decisions may be taken which are unwholesome from the total point of view. As long as it does not depend on the corporate resources, it may tend to operate independently. The international division may enter into various contractual arrangements, including joint ventures in overseas markets.

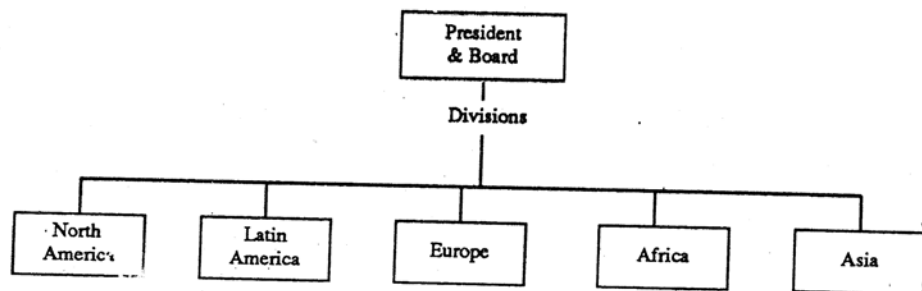
Such an organisation, is suitable under the following conditions:

- when foreign sales are relatively small to the domestic sales,
- when activities are spread over a limited number of countries,
- when product lines are few, and
- when the demand pattern is homogeneous.

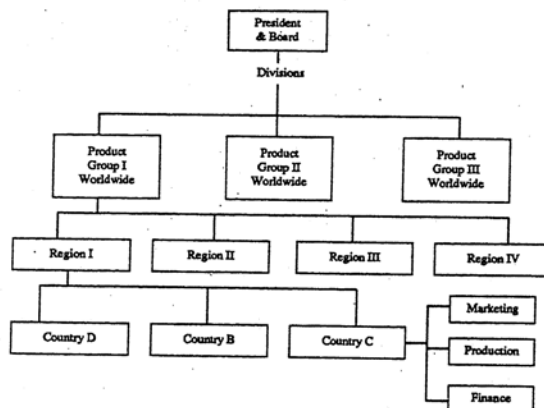
Type-D structure emerges when the international operations continue to grow. The critical psychological level is reached when the international activities become equal or greater than any one of the activities of the domestic division. At this stage, strains may develop due to the size of operations and heavy flow of communications. The international division gives way to product groups which are given, concurrently, the world wide responsibility in case of wide product line companies. A world wide product based organisation is responsible for production, marketing and profitability of products throughout the world. A comparatively narrow product line company will organise itself into and have a region-wide integration e.g., North American, Latin American, Western Europe, Asia and so on. (see Figures 4A & 4B),

**Type D. Multinational Firm**

**Figure 4.4A : Organisation : Narrow Product Line**



**Fig. 4.4B: Organisation: Wide Product Line**





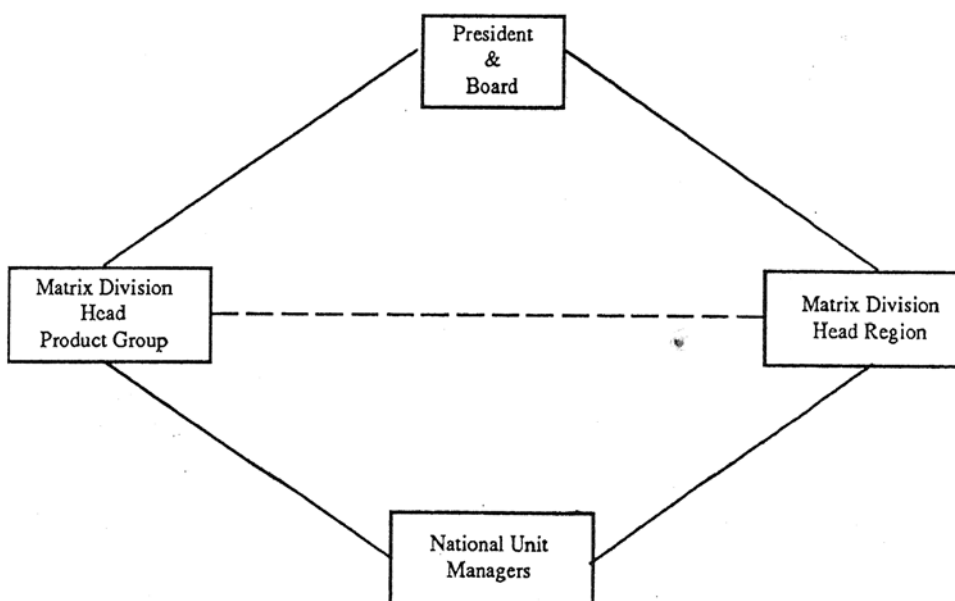
The units in the countries within a region are likely to be fairly interdependent. A Structural Design firm at the stage of its evolution is a multinational firm. The ownership and management of the parent corporation is essentially with the materials of one (i.e., parent) country. The firm has units/subsidiaries in different countries but its production system is integrated internationally (i.e., centralised control of production). The centralised control is based primarily on ownership, i.e., equity based control. Most top corporate managers are novice-country materials. Initially all decision making in relation to subsidiaries may be centralised at the headquarters. However, as the firm grows overseas, political pressures develop to compel greater local control and newer subsidiary autonomy. It is also quite possible that as the firm gathers more environmental expertise in headquarters and perceives more clearly the advantages of greater integration, it will attempt to reestablish central control over its foreign operations.

Type-E **transnational firm** attempts to integrate worldwide operations, and seeks to serve the stakeholders in each nation. A transnational firm is owned and managed multinationally, i.e., ownership and management of the parent corporation resides in the hands of the nationals of more than one country. The decisions making may be centralised, but is free of national bias, except as legally imposed. The firm loses loyalty to a single nation. The members of a transnational firm develop loyalty to the firm of a sort that transcends national identity. The national outcome is that, convert of psychologically based national bias in decision making is eliminated and this may result in better allocation of corporate resources. When a multinational firm acquires the character of transnational firm and in the process loses its hitherto national loyalty, it may bring the latter to some kind of friction with its (establish) parent government. Thus, the evolution of a multinational to a transnational firm may bring with its significant changes in its behaviour. A transnational firm may generally have a matrix structure which tries to integrate three dimensions: functional areas, product lines and regions. This provides sufficient decentralisation to national managers to meet regional needs and the needs of product lines. However, there is a centralised coordination system (Figure 4.5).

It has been observed that the traditional organisational structure (independent international division) is now changing fast into global product divisions because of the inherent competitive advantages of the latter. The benefits such as cost effectiveness, improved communication and resource transmission, and above all, a global strategic focus are the main reasons for a more worldwide organisation. Thus, an MNE goes through a series of structural changes in search of more suitable design fitting its strategy. The organisational structure keep on changing in response to the strategies adopted by an MNE.

#### Type E: Transnational Firm

Fig. 4.5: Matrix organization





**Activity 1**

Identify the organisation structure adopted by the parent company of your unit (if it is a subsidiary). Draw the organisation chart and discuss the rationale behind such a structure.

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**4.3 MANAGERIAL ATTITUDES AN STRUCTURE**

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Perlmutter has identified three types of attitudes in the choice or organisational structure. They are:

Ethnocentric	Home-oriented
Polycentric	Host-nation oriented
Geocentric	Internationally oriented

The international division or multinational product wise division tries to concentrate all concerned activities into a centralised division. Foreign units or subsidiaries are given guidance from the central office. The ethnocentric firm organises itself into product groups, and views the world as homogenous. Most of the staff are from home countries, and they could have less international experience. There might be difficulties in communications and host governments may exert pressures on the MNEs to change ethnocentric attitudes.

A polycentric organisation is based on area. Each region is treated as an independent profit centre. The regional managers control the operations in their region. It responds to local interests more effectively.

A geocentric firm integrates its worldwide operations, and uses a matrix structure. It is staffed by the best men from any nationality.

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**Activity 2**

Identify the managerial personnel in various units of an MNE with which you are familiar, specifically drawing the background of the top management of any one such units.

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**4.4 AMERICAN MNEs**

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The U.S. companies can be identified as belonging to international (or diversion) model (i.e., Type C of Table 4.1). As the key tasks were to transfer knowledge and expertise overseas, the structure and process became important. Though the parent companies transferred new products and processes to the subsidiaries, they were free to adapt them to the local conditions. The structure was that of a 'coordinated federation'. The decisions on assets, resources and responsibilities were decentralised with control from headquarters. This was achieved through formal planning and control systems. The structure is that of a multinational form but subsidiaries are dependent on headquarters.

Studies of the U.S. Companies during the 1960s revealed that they had three types of structures: international division, area-based global structure and product-based



global structure. The United States MNEs have widely used international division type of structure with domestic orientation. However, by the end of the 1960's, many MNEs gave up the international division. This was due to the mature nature of MNEs. For instance; UNIVAC division of Sperry-Rand International Corporation abolished international division due to the difficulties they faced in transferring ideas from the domestic groups to international operations. Similar experiences led several U.S. companies to change to the area or product based global structures.

The U.S. companies had no non-U.S. members on their subsidiary boards until recent years. When the U.S. companies moved towards the multinational (or international diversion) structure, regional headquarters were established. However, they faced the following problems:

- The personnel assigned had little international experience
- The psychological barriers came in the way of allocating corporate resources in the interest of global optimisation.
- Non-availability of the headquarters' personnel led to the employment of local managers.

These factors led the U.S. companies to move towards multinational structure with polycentric orientation.

It may be stated that the number of the MNEs in the United States with global product/area-based structures is still low. According to the study conducted by Hulbert and Brandt James M. Hulbert and William K. Brendt, *Managing the Multinational Subsidiary*, Holt, Rinehart & Winston NY 1980, the multinational companies with geocentric attitude accounted for one third of the companies surveyed while two thirds followed international division structure.

## 4.5 JAPANESE MNEs

The Japanese pattern of multinational business is closely related to the operations of their trading companies. The organisational structure of the Japanese companies developed on the basis of the information collected by them in the process of exporting and their linkage with the major banks providing financial resources.

Traditionally, the focus in the overseas operations has been more on trade than business. The level of multinationalisation is low in personnel management but high in functional areas such as R&D, marketing and finance. The stages of internationalisation and organisational structure with respect to the Japanese international operations are given in Table 4.2.

**Table 4.2: Stages of the Organisation of Japanese MNEs**

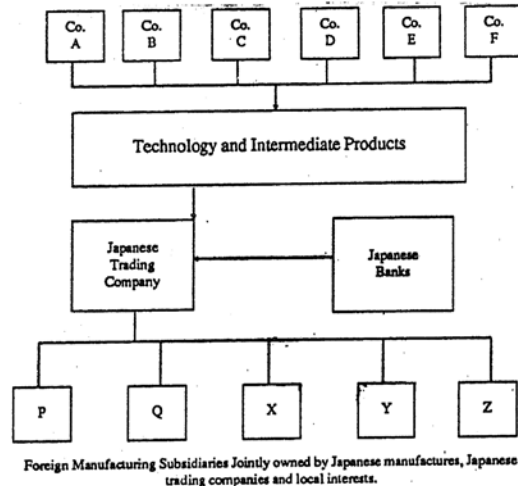
Stages Management Perspective	Focus	Organisation
I) Management by HQ	Trade, Technology licensing	Export Department
II) Delegation of Management to Operating Units	Overseas Production units coordinate all aspects	Overseas projects department/International business department
III) Regional Coordination	Overseas business a more central role	Full-time director for overseas projects department*
IV) Management from a global perspective	Separate management of overseas operations	Separate operational HQ or special subsidiary
V) Integrating global into the firm as a whole	Global perspective both domestic and overseas operation	Re-integrated in a unified organisation

The Japanese companies are considered to be on the 'global organisation' model (Stage V of Table 4.2). This model assumes centralised assets, resources and responsibilities. The overseas operations are a means to reach foreign markets to build global business. The subsidiaries have a limited role of implementing plans and



policies of the headquarters. The character of the structure is like that of a 'centralised hub'. Even after opening subsidiaries in foreign countries for manufacturing, the web-like structure (see Figure 4.6) of the trading companies remained intact, reflecting their importance. The Japanese multinational trading companies have their domination on the different aspects of involvement in international business. The subsidiaries operating in foreign countries are not independent with regard to decisions on sales promotion and selection of distribution channels. They have to seek advice from their parent trading companies. The parent trading companies continue to perform search, financing and control functions. The Japanese companies do not yet permit the non-Japanese on their boards.

**Fig. 4.6: Shows the scheme of Japanese trading company's multinational structure.**



The Japanese MNEs have a special problem in the multinational management. The strength, which led them to become 'Kaisha', has turned to their disadvantage in dealing with personnel, legal requirements and social customs in different countries. Most of the subsidiaries are managed by the Japanese expatriates. All the basic decisions are made by the head office in Japan. The handicap is that Kaisha is based in a homogenous society, and is an integrated institution.

NEC of Japan leaves personnel matters to the local non-Japanese and tolerates differences. Fujitsu has shares in Amdahl but does not involve in the management of Amdahl. So far the Japanese companies have not considered foreigners in the management of their companies.

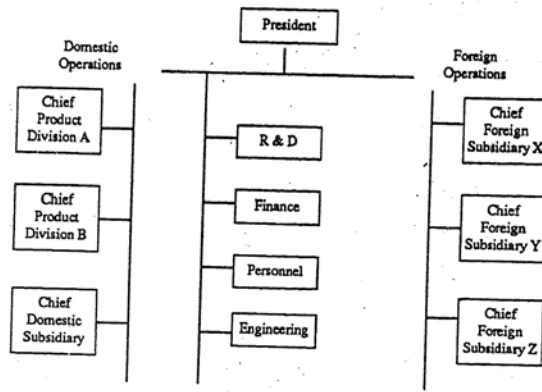
## 4.6 EUROPEAN MNEs

The European international companies, at the initial stage, followed "mother daughter" form of organisation (see Figure 4.7) which involved personal and informal contacts between the parent company and the subsidiary rather than a formal system. The reason was that the subsidiaries operating in the colonial territories administered by the home countries of the parent companies enjoyed certain competitive advantages, e.g., tariff concessions. They were given autonomy, except in the case of large scale capital investment. Every national unit was treated as an independent entity. With increasing competition in the world market, this type of organisation has gradually been replaced by divisionalised and global structures (i.e. Type D of Table 4.1) which provide for greater coordination. Hulbert and Brandt in their study of the organisational structures of United States, European and Japanese multinationals found that European companies had lately become more global oriented in contrast to the U.S. companies. Forty four per cent of the European companies used global structures. The companies operating through the international division structure, according to this study, accounted for only 17 per cent.

The European companies had in their boards nationals of the countries where they exported or manufactured. The management systems are built around a "world federation of national organisations", which are responsive to environmental changes. Most of them are both global and local in their overseas operations.



**Figure 4.7: shows Mother-Daughter International Structure**



**Indian Multinationals**

Indian companies, mostly, limit themselves to exporting, and are thus ethnocentric in orientation. They have gone across the Indian borders mainly to avail of export incentives. A very few companies in India have moved to the international division structure. The number of companies adopting global organisational structure is insignificant.

**Activity 3**

Try to obtain organisation structure of one MNE each of the U.S., Europe and Japan in India. List the commonalities, and differences.

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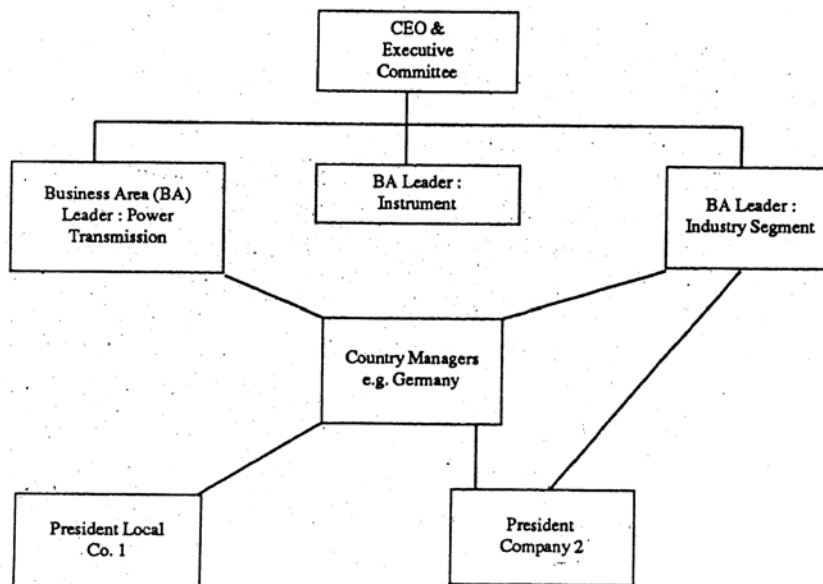
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**4.7 ORGANISATION OF ASEA BROWN BOVERI (ABB)**

We will now illustrate the matrix structure with a recent example of ABB. ABB was created in 1987 with the merger of two large European companies: Asea (established in 1890), Sweden and Brown Boveri (established in 1891), Switzerland. ABB started entering trans-Atlantic by acquisition of minority investments in 60 companies in the U.S. The major acquisitions were Combustion Engineering (\$ 1.6 bn.) and Westinghouse's transmission and distribution operation in 1989. The headquarters of the Company is at Zurich. The structure of ABB is presented in Figure 4.8.

**Figure 4.8: Structure of ABB**





All activities of ABB are classified into 50 business areas (BAs). These BAs are combined into eight business segments, and each segment is headed by a BA leader. Each country can have any number of business areas. ABB has a total of 1,200 companies. These companies are again split into several profit centres. There are around 4500 profit centres. It encourages the starting of a new company for each business area in a country.

**Top Management:** Top management consists of CEO and EC members. CEO is at headquarters. The top management consists of CEO and 13 Executive Committee members. They are responsible for the global strategy and performance. Members are composed of several nationalities like Swedes, Swiss, Germans and Americans. They are located outside Zurich. The Executive Committee meets once in 3 weeks. "I he meetings are held around the world.

**Business Area (BA) Leaders:** The BA leaders are members of the Executive Committee. Each heads one business segment (like power transformers, instruments, industry segments, etc.), one region and some staff functions. He is responsible for the global strategy of the business segment, cost and quality standards, allocation of the exports and share of experience by rotating people across borders.

For instance, the BA leader for power transmission is a Swede. The headquarters are at Mannheim, Germany. He controls 25 factories in 16 countries. Each of these units is run as an independent company. The BA leader's job is to set global strategy, and to allow each company's independence to execute (The Motto is: **Think Global, Act Local**). This enables the company to reduce throughput time, maximises design and production flexibility to meet the needs of the domestic customers.

The BA Management Board consists of the BA leaders, who are either Chairmen or Presidents of large companies in the group. It could be located in the U.S., Canada, Sweden, Norway, Germany and Brazil. Their role is to have global strategy for power transformers, review performance and resolve problems. They meet four to six times a year.

The BA staff at Mannheim consists of a few persons, who are responsible for critical activities like purchase, R&D etc. They try to coordinate the local companies. The **BA** leader distributes the detailed information to all the 25 companies under his group. The functional coordination is done through calling all functional managers once or twice a year to exchange details.

**Another BA** leader is responsible for Germany, Austria, Italy and Eastern Europe, located in Germany, with the business area responsibility of installation materials.

**Country Managers:** **ABB**, Germany, has its own chief executive and supervisory board constituted as per the local laws (like having German bank officials and trade union representative in the board). It may have separate companies in Germany in 50 business areas. The country Managers are expected to be responsive to the local conditions in respect of all the companies of ABB in that country.

**Local Presidents:** The local companies have their own presidents. A president has to report to two bosses: the BA Leader and the Country Manager (the regional line managers). That is, if there are several business area companies in a country, each company will report to its country manager and Business Area Leader. The BA leaders may be different, located at two places.

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## 4.8 DESIGNING APPROPRIATE STRUCTURE

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There are many types of organisation structures, which an MNE can adopt in its international operations: Functional, Product-based, Area-based and Mixed structures.

**The Functional Structure** is appropriate for a firm producing standardised products. This is suitable during early stages of an international business, with low product or area diversification. Most of the small firms or extractive industries adopt this form of structure. The divisions are based on major tasks. This provides ease of



supervision, fosters professional identity and allows specialisation. Sometimes, it may cause difficulties in coordinating activities of various departments.

**The Product-based Structure** consists of divisions according to products or services. This simplifies coordination among functions within the division, and allows growth without loss of control. As the divisional goals are clear, both authority and accountability for decisions is with the product division. This structure is suitable when the company has dissimilar product lines. Such structures are adopted by , automobile companies, e.g., General Motors, Chrysler, etc. However, there are some disadvantages in such structures, like duplication of resources and sub-optimisation among divisions. While it encourages competition among divisions, it might reduce the specialisation of the functional skills.

**Area-based Structure** means divisions according to the end-user regions. It helps in simplifying coordination among functions. Under this form, divisional goals are clear and this permits the growth without loss of control. It also allows proper authority with accountability in the division. This structure is suitable for a mature company with narrow product lines. Area-based structure is used by pharmaceuticals, food and beverage MNEs. The disadvantages are similar to the product-based structures.

**The Matrix-based Structure** has two dimensions, viz., product and area. It attempts to balance the two. While this structure provides resource flexibility and balance in the organisation, it results in dual reporting responsibilities: the matrix structure enables more information flows and helps control at headquarters. This is suitable for the MNEs, which are facing two equally important challenges. Many electronic companies, like General Electric and Philips, have adopted this structure. Experience indicates that this structure may be unstable, and might sometimes lead to conflicts due to the dual authority.

There might be a hybrid type of organisational structures. The hybrid type could combine elements of two structures to minimise the disadvantages, e.g., functional-cum-product based.

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#### Activity 4

Approach a knowledgeable executive of a multinational subsidiary, and obtain information on the structure of the parent company. Evaluate its appropriateness.

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## 4.9 SUMMARY

In the context of the international operations, a firm may pass through five-stage evolution. Transformation from one stage to another depends upon its involvement, commitment and other attributes. Along with the changes in structure, the managerial attitudes and personnel manning the various units may also change. Due to historical and cultural factors, they may have ethno-polity-or geo-centric emphasis. The structural and attitudinal characteristics of the MNEs of American, Japanese and European origin were described. An illustration of ABB was given to highlight the current experiments in the structure of the MNEs. Finally, some indications were provided on choice of appropriate structure out of four basic structures, viz., Functional, Product-based, Area-based and Mixed structures.

The organisational structure of the multinationals has grown from a simple export department to the International division, having subsidiaries and joint ventures in several countries. With increasing competition in the world economy, the organisational structures of the MNEs has moved to product/area based and global matrix forms. The organisational structure of the international business has evolved in response to the strategies adopted by the MNEs in the different phases of their growth.




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## 4.10 KEY WORDS

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**International Division:** A separate division is formed exclusively to look after foreign business.

**Multinational Firm:** A firm with units/subsidiaries in various countries, but with an internationally integrated production system. International business is divided into region-wise or product divisions, looking after both domestic and international operations.

**Transnational:** A corporation (parent company) owned and managed by the nationals of more than one country. Decisions are free of the national bias. The firm follows global strategies. *The* total business is integrated, and a matrix structure emerges.

**Matrix Organisation:** Attempt to integrate functions, product-line and regions. A national unit will report to two bosses.

**Ethnocentric:** Management attitude and the personnel are home-country oriented.

**Polycentric:** Management attitude and the personnel are host-country oriented.

**Geocentric:** Management attitude and the personnel are internationally oriented.

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## 4.11 SELF-ASSESSMENT QUESTIONS

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- 1) What types of organisation structure may usually be evolved during different stages of internationalisation?
- 2) Differentiate between the evolutionary pattern of MNEs originating from different countries like U.S., Japan and Europe.
- 3) Does the organisation design of ABB reflect the emerging pattern of MNEs?
- 4) Elaborate on the appropriate design at a particular stage of development of an MNE.

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## 4.12 FURTHER READINGS

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Kobayashi, Noritake, (1985): "The Patterns of Management Styles Developing in Japanese Multinationals in the 1980's" in Susurmu Takauniya & Keith Thurley (ed. 1985): *Japan's Emerging Multinationals*; University of Tokyo Press, Japan.

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