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RESEARCH NOTES AND COMMUNICATIONS

A NOTE ON GLOBAL STRATEGIES

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This article augments, as well as takes issue with, the recent review by Ghoshal on international competition. The central question is what changes strategically when a firm moves from domestic to overseas competition. In analyzing this question, it is shown that there exists a neglected line of relevant research by two schools of thought: the Cambridge (Massachusetts) axis and internalization theory. The recent focus of research is described as understanding the multinational corporation as a network competing on its flexibility and the transfer of acquired capabilities across borders.

The article by Sumantra Ghoshal (1987), entitled 'Global strategy: an organizing framework', is a well-written and fluent review of a growing literature on international competition. I would like to augment his review by describing the earlier work on foreign direct investment as an outcome of oligopolistic rivalry, as well as the work on internalization arguments. The significance of this augmentation rests in (1) giving a sense of direction to the development of research on international competition and (2) showing how some of the current parlance is derived, and in some cases better explained, in this earlier work.

In augmenting Ghoshal's review, I take the opportunity to make three critical points. The first is to address, briefly, some of his criticism of my work. The second is to show that the unique aspects to international competition are fewer than suggested. If we are to avoid the wastefulness of excessive subdivision of the strategy field, it is important to isolate the incremental difference between a domestic and international setting. The third point is to give a sense of the development of the field from concentration on the initial foreign direct investment to exploring the multinational network as a basis of competition. This history matters, because arguably Ghoshal's identification of the sense of confusion in reading the recent literature arises from neglecting the substantial contribution of earlier writers. It is easier to draw a trend line in current thinking if we look back to other recent points in time.

Whenever new subjects and concepts are proposed it seems fair to ask what is different from what we already know. Analogously, the starting question for an analysis of global strategies is what is different when we move from a domestic to an international context. The traditional answer has been simply that the world is a bigger place, and hence all economies related to the size of operations are, therefore, affected. A more interesting distinction is how differences in national markets create profit opportunities and influence the competitive positioning of firms.

The distinction which I have made is between the locational structure and operating flexibility of the multinational network, which is similar to—though less felicitous than—Porter's configuration and coordination dimensions (Kogut, 1983; Porter, 1986). It is principally the operating side which drives the incremental value of being

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multinational. This operating flexibility stems from the benefits of coordinating the flows within a *multination network*. The value of such flexibility rests not only on exploiting differentials in factor, product, and capital markets, but also on the transfer of learning and innovations throughout the firm, as well as the enhanced leverage to respond to competitors' and governments' threats. This flexibility, as I have underlined elsewhere, is, however, costly and organizationally complex to achieve.[1] Firms vary widely in their recognition of competing on the multinational network, as well as in terms of their ability to do so.

The shift in thinking about international competition in terms of network flexibility is reflected, as will be described later, in the work of many researchers. In order to have a sense of the current direction it is useful to understand the contribution, and continuing merits, of the work done primarily in the 1970s. The earlier writings on the international firm were less concerned with the benefits of being multinational but more with the initial decision to invest abroad. Their primary focus was on the location of investment rather than the operating management of these investments. Prior to 1960, most scholars viewed foreign direct investment as the flow of capital from one country to the next in the anticipation of higher returns. It was Hymer's (1960) distinctive contribution to shift the analysis from countries to industries. To him—and the excellent work which followed by Kindleberger (1969), Caves (1971), Vernon (1971), Horst (1974), Knickerbocker (1976), Graham (1978), and others—international competition was simply the extension of oligopolistic rivalry across borders. The themes of this research should strike a familiar cord with strategists of the industry analysis cloth: entry barriers, competitive signalling, and preemptive investments.

Indeed, the impressive work of the early 1970s, which was largely centered around a Cambridge (Massachusetts) axis, has laid the often unacknowledged foundation to recent theoretical treatments of cross-border dumping, strategic trade theory, and foreign investment as signaling commitment. These ideas underlie the more recent writings on the importance of being able to counter competition in multiple markets (Hout, Porter, and Rudden, 1982) and cross-subsidize across markets (Hamel and Prahalad, 1985).

There are important insights in this early work which are still neglected, though they strike familiar tunes. For example, recent game theoretic treatments of reputation rely upon retaliation in order to attain cooperation. Retaliation is effective even if there is only a small chance that a firm would respond in kind to a competitive price cut. The probability of retaliation multiplied by the aggressor's market share and by the drop in price may not be offset by expected gains to the aggressor if the time horizon is sufficiently long.

Let us take a concrete example. Ford probably thinks twice before cutting price if GM has the reputation for retaliation. But what good is GM's reputation when it has no credible way to affect Toyota's home market share and prices. The cutting of price by GM in the U.S. would hurt (because of GM's much larger market share) itself much more than Toyota. This asymmetry in the game between GM and Toyota has been of fundamental importance. It would seem GM has had only two alternatives: watch its market share fall and Toyota's increase to the point that the latter is worried about retaliation, or try to compete on cost (possibly with the help of Korean and Japanese allies).

In short, being multinational is one way to eliminate the asymmetrical exposure when international competition is between a few players. Yet, though these issues are recognized as important (as did Knickerbocker, 1973, in the conclusion to his book), there is still surprisingly little empirical work on international industry competition. Nor is there a theoretical or empirical treatment of the question of what happens when national oligopolies, following different rules of the game (e.g. cooperative and non-cooperative agreements) collide.[2]

In the mid to late 1970s the focus of work switched from the international extension of oligopolistic competition to the benefits of reducing 'transaction costs' by internalizing trade

[1] Ghoshal faults my work for seeing flexibility as without costs or requiring organizational support. He also argues that operating flexibility is conceived as creating side-bets to cover contingencies. I refer the reader to one article (Kogut, 1985) in order to evaluate these claims.

[2] However, see the recent work of Lyons, 1984, and Casson, 1987.

among countries. (Transaction costs in this literature are often not equivalent to Williamson's definition, since they include strategic motivations, such as being able to price discriminate across markets.) This approach was first suggested by McManus (1972), but became the central focus only after the publication of a book by two University of Reading scholars, Buckley and Casson, in 1976. Concurrent and subsequent contributions were made by Dunning (1977), Hennart (1982), Magee (1977), Rugman (1980) and Teece (1983).

The gist of the argument is straightforward. There are potential costs to relying on markets and contracts; suppliers might cheat, the transfer of technology might be difficult to price, or the creation of forward markets to hedge price risk might be impaired. Because of these market failures there is a benefit to being multinational, due to the possibility of internalizing trade within the firm and creating internal markets. There are a number of markets where this argument is especially pertinent, e.g. mineral markets or high-technology markets.

There are some debates in this literature which have yet to be addressed in the broader transaction cost literature. Dunning (1977), for example, distinguishes between internalization and ownership advantage. Internalization falls under the problem of establishing the boundary of the firm. Ownership advantages refers to the proprietary assets of the firm and corresponds to how possession of these assets influence, or are influenced by, the strategic positioning of the firm. There is considerably more work required in flushing out these distinctions, but it is an important contribution to distinguish between the problem of transacting goods and creating and preserving intangible assets.

In part, the work of Lessard, which is admirably summarized by Ghoshal, is also related to the internalization perspective. Agmon's and Lessard's (1977) observation was that diversification by real capital investments across borders is valuable if there are impediments (i.e. the absence of capital markets) to the flow of portfolio investments. This value stems not from better management of risks, but from the reduction in risk premia attached to an internationally diversified firm as opposed to one which is wholly domestic. The benefit of diversification is incremental to being multinational relative to domestic; it is not a question of better risk management relative to that of other multinational corporations. It is, on the other hand, tough to manage the exposure created by exchange rate—as Lessard's other work (1986) has carefully analyzed—but managing better is always good, whether a firm is international or not.

The dominant framework for the analysis of global strategies at this time was that of global integration and national adaptation.[3] Benefits of a larger market encourage, so the underlying logic suggested, standardization to capitalize on scale economies, but country differences impede such efforts. This trade-off was largely focused on end-products and the problems of market access. At the same time, the prevailing wisdom on the organizational design of the multinational was of product and area divisions, with staff functions being under corporate and divisional control.

It was a minor but non-trivial adjustment to alter this framework so that the global integration and country adaptation trade-off may be resolved by standardizing some links of the value-added chain and differentiating other links. Not surprisingly, the differentiated links frequently entail downstream activities. In this sense the international value-added chain is simply a twist on the original integration and differentiation choice.[4] But there is an important implication of this adjustment that is not often reflected in current empirical work, namely, a standardization and national differentiation typology is too simple and inaccurate if focused only at the market for final goods.

The fundamental change in thinking about global competition in the 1980s has been the shift in interest over the decision to invest overseas to the strategic value of operating assets in multiple countries. An important element in this shift is the distinction between increased

[3] The origins of this framework are to be found, Stephen Kobrin has reminded me, in the work of John Fayerweather (1969), but its most influential expression derives from Prahalad (1975). It was expanded by Doz (1979) to include the role of governments and by Bartlett (1979) in terms of the organizational prerequisites at the country level.

[4] For two views on this adjustment, see Kogut (1984) and Porter (1986). My article was derived from a set of 1982 teaching notes which benefited from suggestions from Don Lessard.

economies due to serving a larger market and the acquisition of advantages built upon the multinational network. On the cost side these advantages are achieved through scale and scope economies, learning (inclusive of the transfer of organizational practices across borders), and exploiting options written on movements in national conditions.

Ghoshal's Table 3 summarizes this emergent view and provides, simultaneously, a decision tool for managers. In this table the columns represent the following sources of competitive advantage: national differences, scale economies, and scope economies. The following strategic objectives are given as the rows: achieving efficiency, managing risks, and innovation, learning, and adaptation. The discussion of each of these individual categories is creative and well done.

Yet the matrix is misleading in a few regards

tive evaluation of the costs and merits of learning and innovation. It is incomplete reasoning to say that learning must be traded off against efficiency, for learning is a source of advantage in which firms frequently knowingly invest and exploit with associated efficiency and risks. The decision by aircraft manufacturers to centralize airframe assembly, but contract internationally for other parts, is based on the efficiency merits of localized learning at the cost of the risk of labor interruption.[6] It is reasonable, as well, to ask if adaptation to local managerial practices is efficient, inclusive of the revenue impact if this adaptation should be useful in the future to the rest of the corporation.

This latter point of the revenue impact of transferring future benefits back to the rest of the corporation provides insight to why this reasoning is incomplete when framed as a trade-off, but still of merit. It is an important point

It might be worthwhile to build research and development or manufacturing facilities in order to ascertain, understand, and transfer such innovations as they occur.[8] It is an outright error to call the investment in such options as a trade-off with efficiency or as narrowly falling under the management of risk as side-bets. To the contrary, such investments represent the incremental value of managing foreign subsidiaries as a network instead of as a set of dyadic relationships between headquarters and subsidiaries. Thus, the recognition that multinationality can be valued as a bundle of options has significant implications for the organization and management of the international firm.

Similar observations were made in earlier texts as well. As part of the Cambridge axis, Franko (1971) and Stopford and Wells (1974) had analyzed the conflict between serving subsidiary versus network goals, especially in the context of losing flexibility as a result of joint ventures. The most explicit early description of the multinational corporation as competing on flexibility is to be found in Vernon's (1979) discussion of the global network in terms of scanning abilities. He writes of the global scanner's innovative response to a threat in some national market:

> The firm might launch the innovative process in the market that had produced the stimulus; or, if economies of scale were important and an appropriate facility existed elsewhere in the system, in a location well removed from the prospective market. In either case, once the innovation was developed, the global scanner would be in a position to service any market in which it was aware that demand existed; and would be in a position to detect and serve new demands in other markets as they subsequently arose.

Acknowledgement of the importance of network flows can be found in textbooks as well, such as Robock, Simmonds and Zwick (1977), Robinson (1978), and especially Franklin Root's *International Trade and Investment* (1973).[9]

Despite these observations on the multinational network, the benefits of utilizing and transferring local resources among subsidiaries only became highlighted in later work. Of course, having the potential to exercise flexibility is a far cry from having the management system to do it. The earlier work on the multinational corporation had emphasized product and area divisions which were suited to the management of dyadic relationships between headquarters and subsidiaries. The structures also presumed that subsidiaries would be implementers of corporate plans and product developments.

Competing on the basis of the multinational network may not be conducive with these previous structures. To a great extent the fountainhead of the ideas regarding the organization of the multinational network is Perlmutter's notion of the geocentric firm (Perlmutter, 1969).[10] More recently, Bartlett (1986) and Bartlett and Ghoshal (1986) have been concerned with outlining how the management of an integrated network is critical to the exploiting of the resources of national subsidiaries for the larger system. Prahalad and Doz (1987) give an insightful analysis of managerial resolutions of the global integration and local responsiveness conflict in terms of a wider interdependence among subsidiaries. Hedlund's (1986) heterarchy is the boldest statement of the organizational aspects of competing through multiple centers and the transfer of learning from country subsidiaries throughout the network.

From an international managerial perspective, the challenge is not simply the dyadic implementation of headquarters' desires in a local market, as specified in the important work of the 1970s and early 1980s. Rather, it is the creation of organizational structures and systems which permit the exploitation of opportunities inherent in the network of operating in different national environments. There is no argument that this is hard to do, and some firms do it better, or that the notions of centralization and decentralization fail to capture the importance of network coordination. It also may be true that it is more easy to isolate the substantive strategic content of an international strategy than to define the operating systems to pull it off. But the

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[8] See Ronstadt (1978) for a discussion. Note, however, that the internalization literature is relevant to analyzing why these assets must be owned rather than relying on the market to purchase the innovation.

[9] Robock, Simmonds, and Zwick (1977: 400) has, moreover, a strikingly temporary discussion of the ITT's advantage over local competitors due to 'cross-fertilisation' across its dispersed laboratories and factories.

[10] For an analytical treatment, see Rutenberg (1982).

management question should be seen as a complement, as opposed to a substitute, to the identification of the content of an international strategy.

It seems fair, to close with our initial point, to ask what is the analytical value of prefacing strategy with the word global. What is distinctive in the international context, besides larger market size, is the variance in country environments and the ability to profit through the system-wide management of this variance. The amount of empirical work done on issues of international competition, involving both management as well as industry structure issues, is impressive. It may be of benefit if, along with the conflicts, the cumulative results of a long line of research are stressed.

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