J. William Widing, Jr.

Reorganizing your worldwide business

Many MNCs complicate organization strategy because they do not understand the operational implications of structural change

Foreword

A number of signals can warn a company with international operations that its organizational structure is obsolete. Yet few companies have learned to recognize these signals in time to achieve the most effective structural change. The result, in many cases, is poor integration of domestic and foreign operations and an organization structure that is not appropriate to either current marketing needs or long-range objectives. Drawing on his experience with multinational organizations, the author explores the reasons why companies fail to heed critical signs of organizational obsolescence and face squarely the complex challenge that global economic variables add to the more familiar problems in domestic markets. He examines such issues as identifying the need for reorganization, integrating foreign and domestic operations, and designing and evaluating organizational alternatives.

Mr. Widing is President of Dasol Corporation, a physical distribution consulting firm. He was formerly a Vice President of Harbridge House, Inc., and has served in staff capacities for two leading U.S. multinationals.

Not too long ago, the attention of today's multinational corporations was focused on organizing for foreign business operations. This interest naturally corresponded to the needs of the late 1950's and early 1960's when U.S. corporations began to undertake major foreign operations.[1]

Now, following a decade or so of accelerated expansion abroad, U.S.-based MNCs are, not surprisingly, *reorganizing* their foreign operations with increasing frequency. In 1971 alone, such diverse MNCs as Borden, Monsanto, USM, Westinghouse, and Weyerhaeuser announced major structural reorganizations. And some of these regroupings are actually second- or third-generation changes. In short, both the increasing frequency and the magnitude of recent reorganizations make it clear that organizational change in multinational business is becoming a way of life, just as it has been for many domestic companies.

Yet, while some MNCs have addressed this concern insightfully and successfully, others lack a sense of multinational organizational dynamics and display little interest in it. With regard to reorganization, most U.S. managers are used to dealing in two-dimensional situations where the potentially conflicting demands of functional and product-line requirements must be resolved in the domestic market. The special expertise required of the multinational manager

1. See, for example, Gilbert H. Clee and Alfred di Scipio, "Creating a *World* Enterprise," HBR November-December 1959, p. 77; and Gilbert H. Clee and Wilbur M. Sachtjen, "Organizing a Worldwide Business," HBR November-December 1964, p. 55.

is the ability to resolve three-dimensional conflicts involving geographic (or worldwide operational) concerns as well as functional and product-line demands. Thus, what might seem to be simply a difficult decision in a domestic company tends, for many managers, to look like legerdemain in a multinational business.

Attempts to impose the familiar two-dimensional solutions that work at home on the three-dimensional world of international business usually increase rather than decrease organizational stress. And many companies have unnecessarily complicated their worldwide operations because they simply did not understand the structural and operational pitfalls inherent in multinational reorganizations.

My purpose in this article is not to offer any pat solutions to worldwide structural problems (there are none), but rather to shed light on some of the key questions and pitfalls involved in multinational reorganizations. In this vein, I shall discuss these major concerns of international managers:

○ How can one tell with certainty when to reorganize?

○ How, if at all, should one integrate foreign operations with domestic operations? [2]

○ What variations in structural form are best suited to the company's particular goals?

The need to reorganize

The motives for reorganizing an MNC often appear sufficiently different from those cited for reorganizing domestic operations to warrant an approach as exotic as some of the far-off places where a company's products may be sold.

Despite the additional complexities presented by foreign operations, however, the underlying reasons for reorganizing them are very similar to those for reorganizing at home. Three of the most common needs are:

1. To accommodate changes brought about by sales growth.
2. To correct adverse operating results.
3. To introduce new products.

The biggest exceptions to these similarities are reorganizations in response to foreign political changes, which often occur more unexpectedly or involve more drastic changes in ideology than at home (e.g., Marxism in Chile).

What generally does differentiate the reorganization of MNCs from domestic operations is not the cause itself but rather that U.S. management's specific response to the stimulus is often different and more varied abroad. Consider the following case involving a food company that had to reorganize because of sales growth:

The company began selling its products overseas through an export division. Later, as sales grew large enough to support manufacturing, the company opened a number of plants around the world. As part of this growth process, the *scope* of managerial tasks changed from directing export operations to controlling foreign manufacturing and marketing operations. Moreover, the *nature* of the managerial role changed from clerical to functional management, and then to entrepreneurship. Taken together, these factors triggered a structural reorganization in which all foreign operations became part of an international division.

At first, marketing expertise within the international division was concentrated at the national level in individual country subsidiaries. Later, as these subsidiaries grew and operating problems increased, the span of control within the international division became so large that an intermediate organizational level was required. Thus regional or area organizations were created with broad general management responsibility over groups of subsidiaries.

Here, as is often true in international business, geographic influences were dominant. But while growth forced a structural change based primarily on geographical factors, note how different the changes were from the type of geographic structure usually found in the United States—where companies often geographically decentralize the control of sales, but seldom do so for marketing and manufacturing.

As the foregoing example demonstrates, even though the basic reasons for reorganizing domestically and internationally may be similar, geographical influences add a new dimension to the task of the multinational manager. They complicate his decision about what, if any, structural response is called for by a particular problem. Thus, while the food company's reorganization was a success, many other companies have not been so perceptive in determining (a) that a new organizational structure is actually neces-

2. Nonstructural operational devices have been used to achieve greater integration of activities without reorganization; for a summary of those used by three successful organizations, see Paul R. Lawrence and Jay W. Lorsch, *Organization and Environment: Managing Differentiation and Integration* (Boston, Division of Research, Harvard Business School, 1967), Chapter VI.

Exhibit I. Indicators of organizational malaise abroad

Indicators	Characteristics
Conflicts among divisions or subsidiaries over territories or customers in the field.	Most common when a company is expanding into new geographic areas. Also caused by the introduction of new products abroad and acquisitions or mergers.
Failure of foreign operations to grow in accordance with plans and expectations.	May only apply to overall sales in a particular area, or to a particular product line. Obviously more acute if one's share of the market is falling even when sales are increasing.
Lack of financial control over operations abroad.	Related to the company's philosophy of centralization versus decentralization and the degree to which authority is delegated to managers overseas. Further complicated by foreign tax laws and accounting conventions.
Duplication of administrative personnel and services.	Most common when product lines go abroad as extensions of independent domestic divisions, or when major acquisitions are made.
Underutilization of manufacturing or distribution facilities abroad.	Often occurs when various product lines extend operations abroad independent of each other, or when consolidation does not take place after a merger.
Duplication of sales offices and specialized field salesmen.	Common within corporations selling technical products such as specialty chemicals or electronic equipment.
A proliferation of relatively small legal entities and/or operating units within a country or geographical area.	Often results from establishing a new subsidiary each time a domestic division enters a new foreign country, until five, six, or even more function side by side.
A proliferation of distributors.	Overlapping coverage and conflicting interests.
An increase in complaints relating to customer service abroad.	Often a symptom that field marketing personnel do not have a coordinated approach to handling a common customer.

sary and (b) what course of action will produce the best results.

There are, however, some specific indicators of organizational malaise abroad that management can watch for. One or more of the factors shown in *Exhibit I* have been involved in major publicized—and unpublicized reorganizations of MNCs in recent years.

The integration problem

A pivotal reorganization decision concerns the optimum integration of geographically dispersed organizational elements. It involves determining the appropriate degree of cross-fertilization and interaction in all the traditional functional areas; long- and short-range planning, finance, product development, marketing, manufacturing, personnel, purchasing, sales, and physical distribution. Once these links have been properly established, management can gain maximum economy of scale, technological advantage, and marketing impact. Moreover, reorganizations provide an ideal time to adjust these relationships to changing conditions.

Yet, despite general corporate acceptance of the advantages of integration, there are wide differences of opinion on the degree to which the functions of domestic and foreign business should be integrated in particular instances. Consider, for example, these two sets of apparently irreconcilable views on how to approach worldwide marketing:

▽ *A manager with broad experience in consumer products*—"There can be no meaningful marketing on a worldwide basis because it is necessary to cater directly to national traits and preferences in gaining product acceptance."

△ *The director of sales for industrial chemical products*—"My marketing approach to customers must be uniform worldwide because they all face the same technical problems and competitive factors."

▽ *A medical doctor in a pharmaceutical company*—"Our product strategy has to be based on the scientific fact that a given disease is the same everywhere."

△ *A marketing manager in the same company*—"I base my promotion planning on the fact that a campaign for a given product has to be tailored to each country individually."

The difference between the first two views can be understood if one accepts the fact that each individual's formula for success may be correct for his own industry but not for other industries where characteristic buyer-behavior patterns vary. Both men erred, however, in generalizing on the basis of parochial experience, a mistake that most experienced top managers would sense immediately.

The difference between the second two viewpoints is another matter. While they may also reflect differing orientations (science versus business), they are present in the same company and *must* be reconciled if a completely satisfactory marketing program is to be developed. Unfortunately, many MNCs suffer from such unreconciled differences of opinion in middle management, and the result is a continuing discontinuity of operation. Under such circumstances, effective reorganization is impossible.

The integration decision is further complicated by the fact that some functions can be more easily combined than others. Finance and manufacturing, for example, can often be integrated more easily than purchasing and distribution. Management's real challenge, then, is to be incisive enough in analyzing the operative factors in its own organization. Recognizing that these factors may differ quite radically between product lines and functions, management should then select the appropriate degree of integration for each and build it into the reorganization process.

From a standpoint of reorganization, three major fallacies relating to this problem of integration are accepted enough in management circles to merit analysis here. Let us turn to an examination of each of these fallacies.

1. Structure does not matter

If one examines the organization charts of a large number of MNCs, it is clear indeed that "there is no way in which international companies organize their domestic and foreign activities." [3] Yet it does not follow, as many managers seem to believe, either that every organization's structure is different or that differences in structure are immaterial during reorganization.

In order to understand the significance of structural differences, management must be aware of historical trends in structural evolution that affect the way integration is achieved. For example, most U.S.-based MNCs have, at one time or another, established an international division to manage their overseas operations. As they grew, these companies also adopted a multidivisional, product-oriented structure at home. The result, in many cases, was a structural conflict between the geographic orientation of international operations and the product orientation of the domestic operations.

It is not surprising, therefore, that the international division has proved to be a transitional structural form for a number of MNCs. In fact, as growth continued in such companies, their international divisions were often reorganized and replaced by one of these alternative structures:

○ Worldwide product divisions, each responsible for selling its own products throughout the world.

○ Area divisions responsible for all products sold within a limited area.

○ A matrix consisting of (a) one of the foregoing arrangements with a centralized, functional staff involvement, or (b) a combination of area operations, worldwide product management, and multiple functional links.

To put it simply, domestic and foreign operations are often not closely integrated during early stages of growth but may be more closely linked during later reorganizations. When contemplating such a reorganization, management should recognize the varying utility of each of the foregoing structures. For example, the *worldwide product division approach* makes it easier to achieve product and marketing integration, the *area division approach* emphasizes regional or geographic integration (at the expense of close ties to the home country), and the *matrix approach* promotes integration of functional activities between corporate headquarters and the field.

In other words, structure *does* matter. Each form of organization has its own special operational characteristics that should be matched to

3. Arvind V. Phatak, *Evolution of World Enterprises* (New York, American Management Association, 1971), p. 109.

the particular integration and strategy objectives of an MNC at any given point in time. There is ample evidence that these characteristics transcend geographical, corporate, and product differences.[4]

2. *Structure must be geographic*

Despite the belief of many managers that ethnic and geographic factors should always be reflected in a reorganization, these factors are not a structural given. A structure that reflects geographic differences is more likely to become area- or country-oriented than product line-oriented. This is efficient for products where local preferences are critical to product acceptance or where economic factors limit the area in which the products can be profitably distributed. Such an orientation, however, can cause severe operating problems when a company has diverse product lines with different marketing implications. Consider this example:

A U.S.-based MNC was selling two different product lines abroad through a single international division (in the United States, each product line was manufactured, marketed, and sold by a separate profit center). This division had numerous subsidiaries located throughout the world; but each subsidiary was limited to operating in a single country under a managing director who was responsible for the sales of both product lines. Separate marketing and sales forces, selling to separate groups of customers within a given country, reported to each managing director through product-line managers.

The company's strategy worked well for the dominant product line because its market share depended on product acceptance by national opinion makers, variations in gross national product and disposable income, and other influences that a country-oriented organizational structure could address directly and efficiently. This geographic orientation, however, created some serious problems for the managers of the secondary product line in each subsidiary.

First, top division executives and subsidiary managing directors had almost invariably been promoted from the sales or marketing groups of the dominant product line. And, quite naturally, they tended to give first priority in funds, facilities, and personnel to the part of the business they knew best.

4. See, for example, John R. Stopford and Louis T. Wells, Jr., *Managing The Multinational Enterprise* (New York, Basic Books, Inc., 1972), p. 5.

Second, since the managing directors had little experience with the secondary product, they did not really understand problems that were related to it. As one product-line manager put it, "The people who know our business don't make the decisions."

Third, the country by country subsidiary structure was inappropriate for the secondary product line because its markets (which were agriculturally oriented) transcended national boundaries and were more related to broad geographic and climatic regions. While the secondary product managers pleaded for a reorganization of their marketing and sales operations along regional lines, their requests were not favorably received by country-oriented division management. The result was that low morale, internal friction, and low effectiveness substantially reduced the productivity of their group.

Obviously, geographic influences play an important role in many multinational reorganizations; but, as this example shows, overemphasis on national or geographic differences can block viable international consolidations. For some reason, many managers seem convinced that they should not take an action abroad that they would take with little hesitation in this country. As one European-based manager of a U.S. MNC put it:

"My company's top managers have just discovered the rest of the world—although it was always there. They are fascinated by the differences they see, and this has been reflected in the way we organize and operate. But *today* one should think of consolidation, not differentiation."

3. *Integration is not possible*

Because of the problems and pitfalls already discussed, top corporate managers, although experienced in solving *domestic* reorganizational problems, have often been so frustrated in their attempts to integrate foreign and domestic operations that they adhere to the fallacy that it cannot be done. Moreover, some managers of foreign subsidiaries denigrate integration in order to retain their independence. The facts, however, prove otherwise.

Here, based on an examination of many corporate experiences, are various structural and operational devices by which a number of MNCs have achieved significant integration:

○ Require financial managers in all overseas operations to report directly to corporate-level line or staff managers in the home office rather than to local managers abroad.

○ Demand uniformity at home and abroad in financial reporting, budget preparation, accounting, and allied areas (although this often leads to the maintenance of two sets of books, one to conform with local laws and practices and the other to conform with U.S. policies).

○ Maintain product uniformity by requiring manufacturing plants abroad to follow U.S. technical design, quality control, and manufacturing standards.

○ Exercise centralized control over pricing and costs for interdivisional transfer purposes.

In short, while many multinational managers still adhere to self-sufficient international divisions or independent area divisions (and often for the wrong reasons), the current trend among U.S.-based MNCs is toward greater integration of foreign and domestic business. For example, a recent survey of the relationship between the home offices and European operations of 127 U.S. companies revealed that 40% of these companies already had strict control over their European subsidiaries, 40% had loose control, and 20% had varying degrees of control.[5] Moreover, where changes were being made, there was a clearly discernible trend toward stricter control, despite frequent disclaimers to the contrary from U.S. headquarters executives.

One popular approach to achieving integration is to assign worldwide marketing and production responsibilities to product-line managers in the United States, as Westinghouse did when it reorganized in 1971.[6] Another approach, followed by Monsanto, established four relatively autonomous worldwide operating companies, each responsible for manufacturing, marketing, and selling its own products to customers worldwide.

Unmistakably, integration of domestic and foreign operations not only is possible but also is becoming more widely accepted, although, for various reasons, managements are not always willing to acknowledge that organizational ties will be appreciably strengthened.

Selecting a structure

Reorganizations of worldwide businesses have been accomplished in many different ways. Yet many MNCs, because of uncertainty or internal political pressures, overcomplicate and unnecessarily prolong the selection of an organizational structure that fits their marketing strategy and long-range objectives. In some cases, the real goal behind a reorganization has been to prevent past situations from happening again. In other cases, management has reacted to transient current problems without carefully assessing either probable changes in environmental conditions or the impact of future plans on the current organization.

Both approaches, in failing to adequately focus on the future, can create a new organization superbly structured for the wrong time frame. Eventually, of course, management recognizes the increasing incompatibility between changing environmental demands and the organization's ability to respond to them. Then further reorganizations will be required to correct the stresses caused by the first miscalculation.

My purpose in this section is to provide some guidelines that should help managers avoid these and other costly mistakes. Corporate experiences with the international division structure as well as the three alternative structures mentioned earlier—worldwide product divisions, area divisions, and matrix—provide the basis for a rough screen to test the validity of proposed alternatives and to simplify the decision-making process. *Exhibit II* summarizes the general suitability of the four organizational structures as they relate to some common management concerns. Here, in more depth, are some observations in light of those concerns:

What is the relationship between organizational structure and rate of growth? Corporations using the worldwide product division structure have grown about 50% faster than those using the area division structure. Whether this is cause or effect is debatable, but there seems to be a preference for worldwide product divisions in situations involving rapid growth.

How do companies with diverse product lines organize abroad? The greater the diversity of product lines, the more likely it is that a divisionalized company in the United States will manage its foreign business by using worldwide product divisions in preference to area divisions.

Does technology affect reorganization? When they decide to reorganize an international di-

5. Robert J. Alsegg, "Control Relationships Between American Corporations and Their European Subsidiaries," AMA Research Study 107 (New York, American Management Association, 1971).

6. See *Business Week*, October 2, 1971, p. 64.

vision, companies with high-technology products and a divisionalized structure in the United States are far more likely to extend the existing product structure abroad than to adopt an area structure.

How does organization relate to management resources? The international division provides the easiest way to concentrate scarce managerial expertise for international operations. Worldwide product divisions, however, provide the widest possible scope and latitude for individual decision making. And an area division structure requires a large number of broad-gauged managers with general management expertise.

How does organization relate to management control systems? The degree of corporate control desired is relatively independent of organizational structure. Appropriate control levels can be set within any structure, but tighter overall controls are more consistent with a matrix structure. Centralized marketing control is most clearly consistent with worldwide product divisions.

Which structure is best suited to handle local government relations? Area divisions can concentrate most efficiently on developing close relationships with national governments, although an international division can also do the job. Worldwide product divisions cannot handle a variety of such local relationships easily unless management makes special accommodations.

How does organization affect resource allocation? Control over the allocation of resources by country, region, and product line deserves special consideration (even though this might be considered simply one aspect of managerial control), because trade-offs among these factors often make or break the growth or profitability of a product line abroad. An area division structure is likely to predispose management to trade-offs based heavily on geography, a worldwide product division structure tends to favor product factors in such trade-offs, and the matrix structure tends to give greater weight to functional groups. Where do we really want the trade-offs to be controlled? Which aspect—if any—do we want to weight more heavily? These are the basic questions management must answer.

How does organization affect operating costs? While the relative cost of operation varies with the type of structure used, the matrix form tends to be the most expensive. It focuses extra attention on functional considerations and thus requires more staff personnel. Area divisions usually have the leanest staffs and therefore the lowest operating costs.

Exhibit II. Suitability of basic MNC organizational structures to corporate concerns

Area of corporate concern	Level of suitability			
	International division	Worldwide product division	Area division	Matrix
Rapid growth	Medium	High	Medium	High
Diversity of products	Low	High	Low	High
High technology	Medium	High	Low	High
Few experienced managers	High	Medium	Low	Low
Close corporate control	Medium	High	Low	High
Close government relations	Medium	Low	High	Medium
Resource allocation:				
Product considerations should dominate	Low	High	Low	Medium
Geographic considerations should dominate	Medium	Low	High	Medium
Functional considerations should dominate	Low	Medium	Low	High
Relative cost	Medium	Medium	Low	High

What are the latest organizational trends? There is ample evidence that government resistance to continuing expansion by multinational firms is increasing. No longer just a European phenomenon, such resistance is occurring in countries on every continent.[7] To the extent that any organizational structure can help blunt these attacks, it is clear that a form which focuses management attention on local concerns is called for. In this respect, the matrix form is best for large MNCs with diverse product lines. It not only focuses on geographic issues but also provides the machinery for closer integration between field and home offices (through the functional staff overlay).

Concluding note

Reorganization is becoming a way of life for MNCs, just as it has for domestic firms. The

7. See, for example, Peter P. Gabriel, "MNCs in the Third World: Is Conflict Unavoidable?" HBR July-August 1972, p. 93.

choice among available alternatives is easier than it first appears to be, once corporate top management reaches a true consensus about what businesses it wants to be in abroad and how it wants to develop them.

More often than not, however, the unnecessarily complex organizational arrangements found in so many MNCs result from compromises that are basically caused by unreconciled differences of objectives within top management groups. If these differences are not addressed directly, still more compromises will be necessary and further organizational complexity will result. MNCs do not have to have complex structures; rather, they need structures that are suited to their marketing and long-term objectives.

MNCs and national interests

In recent years, as the screening and conditioning of foreign investment have grown more widespread, the range of practices discriminating against foreign-owned enterprise seems to have widened as well. The use of "buy at home" preferences, a long-established policy of government procurement agencies, has now been extended to "buy at home except from foreigners." The procurement officers of some governments are no longer content to screen their suppliers simply by determining whether they are producing locally; local ownership of the producing facilities also is a basis for preference. British government agencies give preference to the product of British-owned computer companies, French agencies to French-owned companies, and so on. Now the European governments are subsidizing research on a fairly broad scale, officials administering the subsidy programs are beginning to raise questions over the ownership of national corporations that apply for subsidy; otherwise, they fear that they may be financing IBM's research in fourth-generation computers. In countries where access to local capital markets is a licensed privilege, the same sort of ownership consideration is being taken into account.

My expectation is that, in the years just ahead, the criterion of ownership will figure even more in the treatment of enterprise than has been the case in the past, and that the tendency will exist both in the advanced and in the less-developed countries. But it is important to make a distinction at this point between discriminatory forms and discriminatory effects. It is not at all clear that nations will actually be able effectively to increase their discrimination against such companies. Indeed, it is here that the nub of the problem can be said to lie. With different degrees of intensity, practically all countries feel that something has been lost if their national industries are not nationally owned; but most countries are also aware that at times more is lost by excluding the foreigner than by admitting him. As the years go on, if multinational enterprises increase somewhat in scope and power, it seems likely that nations will feel that both kinds of losses are growing—that the loss associated with a diminution of national ownership is growing, and that the loss that would be associated with terminating the trend is growing too. That, at least, seems a reasonable inference if the size of efficient units of technology, money, and markets continues to grow. As a result, the issue will be elevated from one of moderate importance in the affairs of nations to one that is rather more significant.

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