CHAPTER 4

Developing a Transnational Organization: *Managing Integration, Responsiveness, and Flexibility*

Having discussed how MNEs are responding to the forces requiring them to develop strategies that optimize the balance among global efficiency, national responsiveness, and worldwide innovation and learning, we now focus our attention on the kind of organizations they must build to manage these often conflicting strategic tasks. In this chapter, we begin by suggesting that this balance involves more than a search for an ideal structural solution; it requires that MNEs not only understand their present and future strategic task demands but also their historic organizational capabilities—something we call a company's "administrative heritage." As they respond to the need to develop transnational strategies, companies must build transnational organizations that reflect their need for multidimensional and flexible capabilities. In the final section of the chapter, we explore the attributes of such organizations, which we describe using a biological analogy, in that we detail the transnational's structure (anatomy), its processes, (physiology), and its culture (psychology). Finally, we examine the processes necessary to build such organizational capabilities.

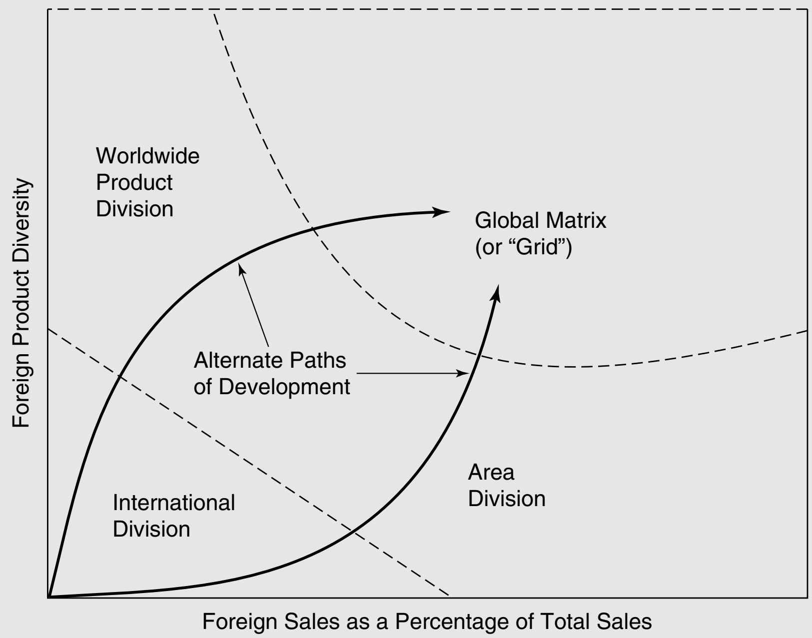
In the preceding chapters, we described how changes in the international operating environment have forced MNEs to optimize global efficiency, national responsiveness, and worldwide learning simultaneously. Implementing such a complex, three-pronged strategic objective would be difficult under any circumstances, but the very act of "going international" multiplies a company's organizational complexity.

Most companies find it difficult enough to balance product divisions or business units with corporate staff functions. The thought of adding geographically oriented management and maintaining a three-way balance of organizational perspectives and capabilities among products, functions, and regions is intimidating. The difficulty is further increased because the resolution of tensions among the three different management groups must be accomplished by an organization whose operating units are divided by distance and time and whose key members are separated by barriers of culture and language.

Beyond Structural Fit

Because the choice of a basic organizational structure has such a powerful influence on the management process in an MNE, historically much of the attention of managers and researchers alike was focused on trying to find which formal structure provided the right "fit" in various conditions. The most widely recognized study on this issue was

Figure 4-1 Stopford and Wells's International Structural Stages Model



Source: Adapted from John M. Stopford and Louis T. Wells, *Strategy and Structure of the Multinational Enterprise* (New York: Basic Books, 1972).

John Stopford's research on the 187 largest U.S.-based MNEs.[1] His work resulted in a "stages model" of international organization structure that defined two variables to capture the strategic and administrative complexity most companies faced as they expanded abroad: the number of products sold internationally ("foreign product diversity" in Figure 4–1) and the importance of international sales to the company ("foreign sales as a percentage of total sales"). Plotting the structural changes in his sample of 187 companies, he found that worldwide corporations typically adopt different organizational structures at different stages of international expansion.

According to this model, worldwide companies typically managed their international operations through an international division at the early stage of foreign expansion. Subsequently, those companies that expanded their sales abroad without significantly increasing their foreign product diversity typically adopted an area structure (e.g., European region, Asia–Pacific region). Other companies that expanded by increasing their foreign product diversity tended to adopt a worldwide product division structure (e.g., chemicals division, plastics division). Finally, when both foreign sales and foreign product diversity were high, companies resorted to a global matrix in which a French chemicals manager might report to both the European regional head and the global chemicals division president at corporate headquarters.

[1]Stopford's research is described in John M. Stopford and Louis T. Wells, *Managing the Multinational Enterprise* (New York: Basic Books, 1972).

Although these ideas were presented as a descriptive model, consultants and managers soon began to apply them prescriptively. For many companies, it seemed that structure followed fashion more than strategy. And in the process, the debate was often reduced to generalized discussions of the comparative value of product- versus geography-based structures on the one hand or to simplistic choices between "centralization" and "decentralization" on the other.

Confronted with increasing complexity, diversity, and change in the 1980s, managers in many worldwide companies looked for ways to restructure. Conventional wisdom provided a ready solution: the global matrix. But for most companies, the results were disappointing. The promised land of the global matrix turned out to be an organizational quagmire from which they were forced to retreat.

Failure of the Matrix

In theory, the solution should have worked. Having frontline managers report simultaneously to different organizational groups (e.g., the French chemicals manager in the preceding example) should have enabled companies to maintain a balance among centralized efficiency, local responsiveness, and worldwide knowledge transfer. The multiple channels of communication and control promised the ability to nurture diverse management perspectives, and the ability to shift the balance of power within the matrix theoretically gave it great flexibility. The reality turned out to be otherwise however, and the history of companies that built formal global matrix structures was an unhappy one.

Dow Chemical, a pioneer of the global matrix organization, eventually returned to a more conventional structure with clear lines of responsibility given to geographic managers. Citibank, once a textbook example of the global matrix, also discarded this mode of dual reporting relationships after a few years of highly publicized experimentation. So too did scores of other companies that tried to manage their worldwide activities through this complex and rather bureaucratic structure.

Most encountered the same problems. The matrix amplified the differences in perspectives and interests by forcing all issues through the dual chains of command so that even a minor difference could become the subject of heated disagreement and debate.

Dual reporting led to conflict and confusion on many levels: The proliferation of channels created informational logjams, conflicts could be resolved only by escalating the problem, and overlapping responsibilities resulted in turf battles and a loss of accountability. Separated by barriers of distance, time, language, and culture, managers found it virtually impossible to clarify the confusion and resolve the conflicts. As a result, in company after company, the initial appeal of the global matrix structure quickly faded into a recognition that a different solution was required.

Building Organizational Capability

The basic problem underlying a company's search for a structural fit was that it focused on only one organizational variable—formal structure—and this single tool proved unequal to the job of capturing the complexity of the strategic tasks facing most MNEs.

First, as we indicated previously, this focus often forced managers to ignore the multidimensionality of the environmental forces when they made choices between product- versus geographically based structures. Second, structure defined a static set of roles, responsibilities, and relationships in a task environment that was dynamic and rapidly evolving. And third, restructuring efforts often proved harmful, as organizations were bludgeoned into a major realignment of roles, responsibilities, and relationships by overnight changes in structure. In an increasing number of companies, managers now recognize that formal structure is a powerful but blunt instrument of strategic change. Structural fit is becoming both less relevant and harder to achieve. To develop its vital multidimensional and flexible capabilities, a company must reorient managers' thinking and reshape the core decision-making systems. In doing so, the company's entire management process—including its administrative systems, communication channels, decision-making forums, and interpersonal relationships—becomes the means for managing such change.

As a first step in exploring some of the more subtle and sophisticated tools, we examine how administrative heritage—a company's history and its embedded management culture—influences its organization and its ability and willingness to change. It is a concept to which we have already alluded in previous chapters when we acknowledged how an MNE's management mentality and strategic posture may have been shaped by different motivations for international expansion, different historical and cultural factors, and different external industry forces.

Administrative Heritage

Whereas industry analysis can reveal a company's strategic challenges and market opportunities, its ability to fulfill that promise will be greatly influenced—and often constrained—by its existing internal world: its asset configuration and resource distribution, its historical definition of management responsibilities, and its ingrained organizational norms, for example. Clearly, a company's organization is shaped not only by current external task demands but also by past internal management biases. In particular, each company is influenced by the path by which it developed—its organizational history—and the values, norms, and practices of its management—its management culture. Collectively, these factors constitute what we call a company's administrative heritage.

Administrative heritage can be, at the same time, one of the company's greatest assets—the underlying source of its core competencies—and a significant liability, because it resists change and thereby prevents realignment. As managers in many companies have learned, whereas strategic plans can be scrapped and redrawn overnight, there is no such thing as a zero-based organization. Companies are, to a significant extent, captives of their past, and any organizational transformation has to focus at least as much on where the company is coming from—its administrative heritage—as on where it wants to go.

The importance of a company's administrative heritage can be illustrated by contrasting the development of a typical European MNE whose major international expansion occurred in the decades of the 1920s and 1930s, a typical American MNE that expanded abroad in the 1950s and 1960s, and a typical Japanese company that made its main overseas thrust in the 1970s and 1980s. Even if these companies were in the same industry, their different heritages would lead them to adopt some very different strategic and organizational models.

Decentralized Federation

Expanding abroad in a period of rising tariffs and discriminatory legislation, the typical European company was forced to build local production facilities to compete effectively with local competitors. With their own plants, national subsidiaries were able to modify products and marketing approaches to meet widely differing local market needs. The increasing independence of these self-sufficient national units was reinforced by the transportation and communication barriers that existed in that era, limiting headquarters' ability to intervene in the management of the company's spreading worldwide operations.

The emerging configuration of distributed assets and delegated responsibility fit well with the ingrained management norms and practices in many European companies. European companies, particularly those from the United Kingdom, the Netherlands, and France, developed an internal culture that emphasized personal relationships (an "old boys' network") rather than formal structures, as well as financial controls more than coordination of technical or operational detail. This management style tended to reinforce companies' willingness to delegate more operating independence and strategic freedom to their foreign subsidiaries. Highly autonomous national companies were often managed more as a portfolio of offshore investments rather than a single international business.

The resulting organization pattern was a loose federation of independent national subsidiaries, each focused primarily on its local market. As a result, many of these companies adopted what we have described in previous chapters as the multinational strategy and managed it through a decentralized federation organization model, as represented in Figure 4–2(a).

Coordinated Federation

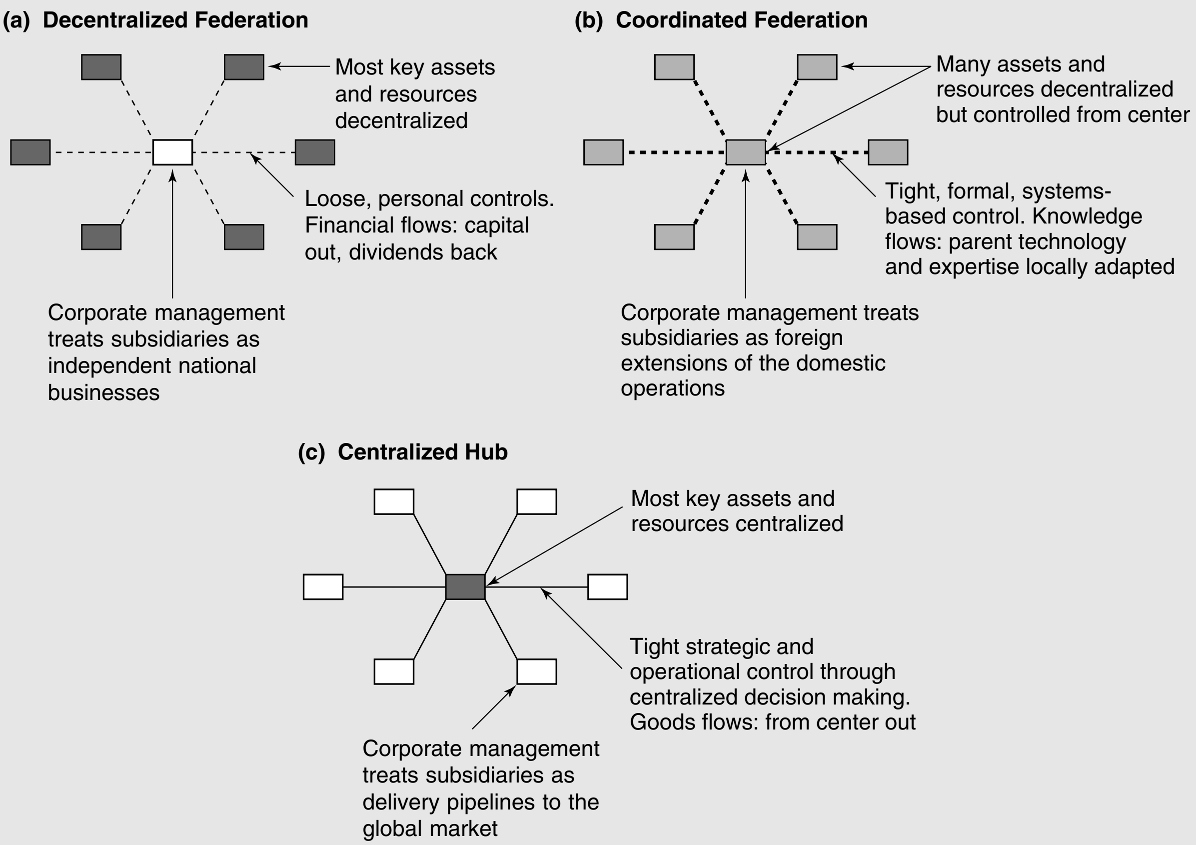
American companies, many of which enjoyed their fastest international expansion in the 1950s and 1960s, developed in very different circumstances. Their main strength lay in the new technologies and management processes they had developed as a consequence of being located in the world's largest, richest, and most technologically advanced market. After World War II, their foreign expansion focused primarily on leveraging this strength, giving rise to the international product cycle theory referred to in Chapter 1.

Reinforcing this strategy was a professional managerial culture in most U.S.-based companies that contrasted with the "old boys' network" that typified the European companies' processes. The management approach in most U.S.-based companies was built on a willingness to delegate responsibility while retaining overall control through sophisticated management systems and specialist corporate staffs. The systems provided channels for a regular flow of information to be interpreted by the central staff and used by top management for coordination and control.

The main handicap such companies faced was that parent-company management often adopted a parochial and even superior attitude toward international operations, perhaps because of the assumption that new ideas and developments all came from the parent. Despite corporate management's increased understanding of its overseas markets, it often seemed to view foreign operations as appendages whose principal purpose was to leverage the capabilities and resources developed in the home market.

Nonetheless, the approach was highly successful in the postwar decades, and many U.S.-based companies adopted what we have described as the international strategy and

Figure 4–2 Organizational Configuration Models



a coordinated federation organizational model shown in Figure 4–2(b). Their foreign subsidiaries were often free to adapt products or strategies to reflect market differences, but their dependence on the parent company for new products, processes, and ideas dictated a great deal more coordination and control by headquarters than did the decentralized federation organization. This relationship was facilitated by the existence of formal systems and controls in the headquarters–subsidiary link.

Centralized Hub

In contrast, the typical Japanese company, making its main international thrust in the 1970s and 1980s, faced a greatly altered external environment and operated with very different internal norms and values. With limited prior overseas exposure, it chose not to match the well-established local marketing capabilities and facilities of its European and U.S. competitors. (Indeed, well-established Japanese trading companies often provided it an easier means of entering foreign markets.) However, the rapid postwar growth of the Japanese economy gave it new, efficient, scale-intensive plants, and it was expanding into a global environment of declining trade barriers.

Together, these factors gave it the incentive to develop a competitive advantage at the upstream end of the value-added chain. Its competitive strategy emphasized cost advantages and quality assurance, demanding tight control over product development, procurement, and manufacturing. A centrally controlled, export-based internationalization strategy represented a perfect fit with the external environment and companies' competitive capabilities.

Such an approach also fit the cultural background and organizational values in the emerging Japanese MNE. At the foundation of the internal processes were the strong national cultural norms that emphasized group behavior and valued interpersonal harmony reflected in management practices such as *nemawashi* (consensus building) and *ringi* (shared decision making). By keeping primary decision making and control at the center, the Japanese company could retain its culturally dependent management system that was so communications intensive and people dependent. In addition, international growth through exporting made it possible for Japanese MNEs to retain their system of lifetime employment. As a result, these companies adopted what we have described as a global strategy and developed a centralized hub organizational model, as we show in Figure 4–2(c), to support this strategic orientation.

The Transnational Challenge

In Chapters 2 and 3, we advanced the hypothesis that many worldwide industries were transformed in the 1980s and 1990s from traditional multinational, international, and global forms into transnational forms. Instead of demanding efficiency or responsiveness or learning as the key capability for success, these businesses now require participating firms to achieve all three capabilities simultaneously to remain competitive.

Table 4–1 summarizes the key characteristics of the decentralized federation, coordinated federation, and centralized hub organizations we have described in this chapter as the supporting forms for companies pursuing multinational, international, and global

Table 4–1 Organizational Characteristics of Decentralized Federation, Coordinated Federation, and Centralized Hub Organizations

	Decentralized Federation	Coordinated Federation	Centralized Hub
Strategic approach	Multinational	International	Global
Key strategic capability	National responsiveness	Worldwide transfer of home-country innovations	Global-scale efficiency
Configuration of assets and capabilities	Decentralized and nationally self-sufficient	Sources of core competencies centralized, others decentralized	Centralized and globally scaled
Role of overseas operations	Sensing and exploiting local opportunities	Adapting and leveraging parent-company competencies	Implementing parent-company strategies
Development and diffusion of knowledge	Knowledge developed and retained within each unit	Knowledge developed at the center and transferred to overseas units	Knowledge developed and retained at the center

strategies. A review of these characteristics immediately reveals the problems each of the three archetypal company models might face in responding to the transnational challenge.

With its resources and capabilities consolidated at the center, the global company achieves efficiency primarily by exploiting potential scale economies in all its activities. In such an organization, however, national subsidiaries' lack of resources and responsibilities may undermine their motivation and ability to respond to local market needs, whereas the central groups often lack adequate understanding of market needs and production realities outside their home market. These are problems that a global organization cannot overcome without jeopardizing its trump card of global efficiency.

The classic multinational company suffers from other limitations. Although their dispersed resources and decentralized decision making allow national subsidiaries to respond to local needs, the fragmentation of activities leads to inefficiency. Learning also suffers, because knowledge is not consolidated and does not flow among the various parts of the company. As a result, local innovations often represent little more than the efforts of subsidiary management to protect its turf and autonomy or reinventions of the wheel caused by blocked communication or the not-invented-here (NIH) syndrome.

In contrast, the international company is better able to leverage the knowledge and capabilities of the parent company (but is still not very good at learning from its foreign operations). However, its resource configuration and operating systems make it less efficient than the global company and less responsive than the multinational company.

The Transnational Organization

There are three important organizational characteristics that distinguish the transnational organization from its multinational, international, or global counterparts: It develops and legitimizes multiple diverse internal perspectives, its physical assets and management capabilities are distributed internationally but are interdependent, and it has a robust and flexible internal integrative process. In this section, we describe and illustrate each of these characteristics.

Multidimensional Perspectives

Managing in an environment in which strategic forces are both diverse and changeable, the transnational company must create the ability to sense and analyze the numerous and often conflicting opportunities, pressures, and demands it faces worldwide. Strong *national subsidiary management* is needed to sense and represent the changing needs of local consumers and the increasing pressures from host governments; capable *global business management* is required to track the strategy of global competitors and provide the coordination necessary to respond appropriately; and influential *worldwide functional management* is needed to concentrate corporate knowledge, information, and expertise and facilitate their transfer among organizational units.

Unfortunately, in many companies, power is concentrated with the management group that has historically represented the company's most critical strategic tasks—often with the cost that other groups representing other needs are allowed to atrophy. For example, in *multinational* companies, key decisions were usually dominated by the country management group because it made the most critical contribution to achieving national responsiveness. In *global* companies, by contrast, managers in worldwide product divisions were typically the most influential, because strong business management played the key role in the company's efforts to seek global efficiency. And in *international* companies, functional management groups often came to assume this position of dominance because of their roles in building, accumulating, and transferring the company's skills, knowledge, and capabilities.

In *transnational* companies, however, biases in the decision-making process are consciously reduced by building up the capability, credibility, and influence of the less powerful management groups while protecting the morale and expertise of the dominant group. The objective is to build a multidimensional organization in which the influence of each of the three management groups is balanced. Some of the cases in this book focus explicitly on this issue of developing and maintaining such a balanced and multidimensional organization.

Distributed, Interdependent Capabilities

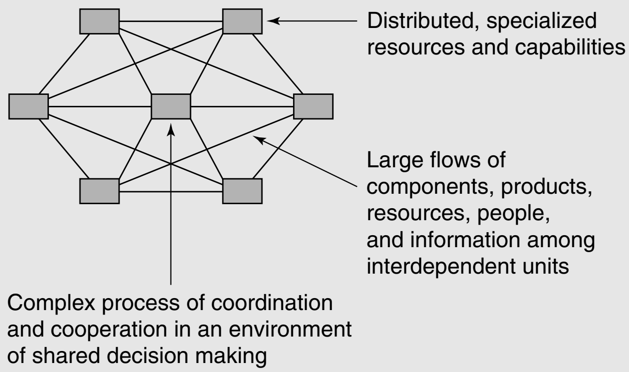
Having developed multidimensional management perspectives to sense the diverse opportunities and demands it faces, the transnational organization must be able to make choices among them and respond in a timely and effective manner to those that are deemed strategically important. When a company's decision-making process and organizational capabilities are concentrated at the center—as they are in the global organization's centralized hub configuration—it is often difficult to respond appropriately to diverse worldwide demands. Being distant from frontline opportunities and threats, the central group's ability to act in an effective and timely manner is constrained by its reliance on complex and intensive international communications.

In contrast, multinational organizations, with their response capabilities spread throughout the decentralized federation of independent operations, suffer from duplication of effort, inefficiency of operations, and barriers to international learning. In transnational organizations, management breaks away from the restricted view that assumes it must centralize the activities for which a global scale or specialized knowledge is important. Instead, management ensures that viable national units achieve global scale by specializing their activities and giving them the responsibility of becoming the company's world source for a given product or expertise. And by securing the cooperation and involvement of the individuals in the relevant national units, they tap into important technological advances and market developments wherever they are occurring around the globe.

One major consequence of such a distribution of specialized assets and responsibilities is that the interdependence of worldwide units automatically increases. Simple structural configurations like the decentralized federation, the coordinated federation, and the centralized hub are inadequate for the task facing the transnational corporation; what is needed is a structure we term the "integrated network" (see Figure 4–3).

In the integrated network configuration, management regards each of the worldwide units as a source of ideas, skills, capabilities, and knowledge that can be harnessed for the benefit of the total organization. Efficient local plants may be converted into international production centers; innovative national or regional development labs may be designated the company's "centers of excellence" for a particular product or process

Figure 4–3 Integrated Network Model



development; and creative subsidiary marketing groups may be given a lead role in developing worldwide marketing strategies for certain products or businesses.

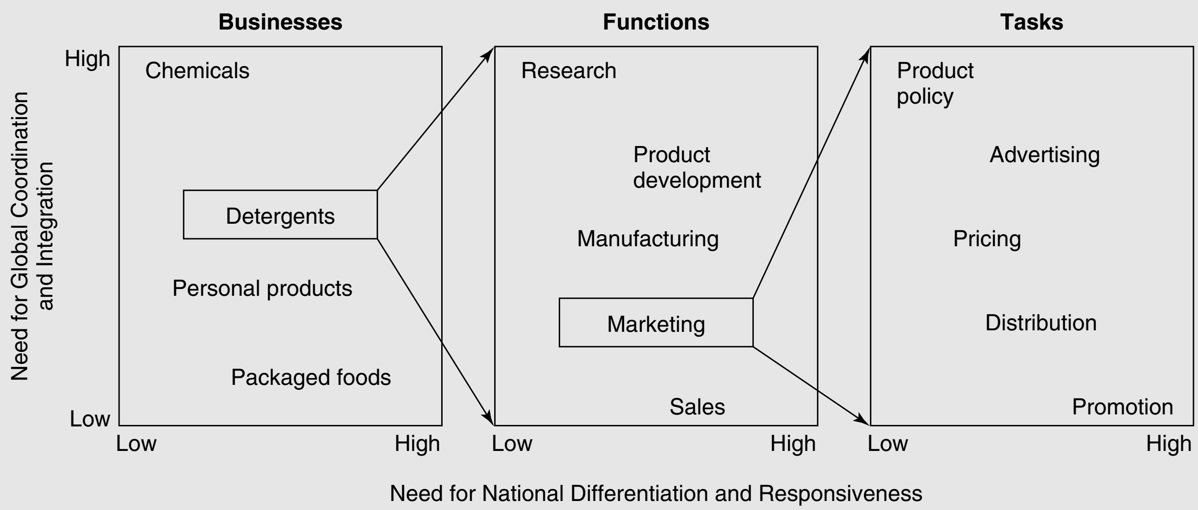
Flexible Integrative Process

Finally, the transnational organization requires a management process that can resolve the diversity of interests and perspectives and integrate the dispersed assets and resources. In doing so, it cannot be bound by a symmetrical organizational process that defines the task in simplistic or static terms, such as, "Should responsibilities be centralized or decentralized?" It is clear that the benefits to be gained from central control of worldwide research or manufacturing activities may be much more important than those related to the global coordination of the sales and service functions. We have also seen how the pattern of functional coordination varies by business and by geographic area (e.g., aircraft engine companies need central control of more decisions than multinational food packagers; operations in developing countries may need more support from the center than those in advanced countries). Furthermore, all coordination needs to be able to change over time.

Thus, management must be able to differentiate its operating relationships and change its decision-making roles by function, across businesses, among geographic units, and over time. In turn, the management process must be able to change from product to product, from country to country, and even from decision to decision. Elaborating on the integration–responsiveness framework we developed in Chapter 3, we illustrate such a distribution of roles and responsibilities in Figure 4–4.

This distribution requires the development of rather sophisticated and subtle decision-making machinery based on three different but interdependent management processes. The first is a focused and constrained escalation process that allows top management to intervene directly in key decision content (e.g., major resource allocation commitments)—a subtle and carefully managed form of *centralization*. The second is a process in which management structures individual roles and administrative systems to influence specific decisions (typically, repetitive or routine activities like setting transfer

Figure 4-4 Integration and Differentiation Needs at Unilever



prices) through *formalization*. The third is a self-regulatory capability in which top management's role is to establish a broad culture and set of relationships that provide a supportive organizational context for delegated decisions—a sophisticated management process driven by *socialization*.

Anatomy, Physiology, and Psychology of the Transnational

The kind of organization we have described as a transnational clearly represents something quite different from its predecessors—the multinational, international, and global organizations. Building such an organization requires much more than choosing between a product or a geographic organization structure; managing it implies much more than centralizing or decentralizing decisions. By viewing the organizational challenge as one of creating and managing a decision process that responds to the company's critical task demands, the MNE manager is forced to adopt a very different approach from someone who defines the problem as one of discovering and installing the ideal structure.

If the classic structural stages model no longer provides a helpful description of international organization development, we need a different way to conceptualize the more complex array of tools and processes discussed in our previous descriptions of transnational organizations. The simple but useful framework adopted here describes the organization in terms of a physiological model. To be effective, change in an organization's anatomy (the formal structure of its assets, resources, and responsibilities) must be complemented by adaptations to its physiology (the organization's systems and decision processes) and its psychology (the organization's culture and management mentality).

We will now describe the different tools and processes used to build and manage the transnational using this physiological model.

Structuring the Organizational Anatomy

As we have noted, the traditional approach to MNE organization problems tended to be defined in macrostructural terms that focused on simple but rather superficial choices, such as the classic "product versus area" structural debate. Developing a transnational organization, however, requires management to pay equal attention to designing and developing a supporting structure that both supplements and counterbalances the embedded power of the dominant line managers.

Having carefully defined the structure and responsibilities of all management groups, the next challenge is to ensure that particularly those without line authority have appropriate access to and influence in the mainstream management process. Microstructural tools such as cross-unit teams, task forces, or committees become important in creating supplemental decision-making forums that often allow nonline managers to assume responsibility and obtain authority in a way that is not possible in the formal line organization.

Whereas once task forces and special committees were considered ad hoc, or quick-fix devices, companies building transnational organizations use them as legitimate and important structural tools through which top management can modify or fine-tune the basic structure. To stretch our anatomical analogy, if the formal line structure is the organization's backbone, the nonline structure is its rib cage, and these microstructural tools are the muscle and cartilage that give the organizational skeleton its flexibility.

Building the Organizational Physiology

One of the key roles of management is to influence the structure of the communication channels through which the organization's decision-making process operates. By adapting the various administrative systems, communication channels, and informal relationships, management can exert a powerful influence—and even control—over the volume, content, and direction of information flows. It is this flow of information—the lifeblood of all management processes—that defines the organizational physiology.

Many researchers have shown the link between the need for information and the complexity and uncertainty of the tasks to be performed. In the integrated network configuration, task complexity and uncertainty are very high. Operating an interdependent system in such a setting requires large volumes of complex information to be gathered, exchanged, and processed. In the complex integrated network that frames a transnational organization, formal systems alone cannot support the huge information processing needs, and companies are forced to look beyond their traditional tools and conventional systems.

For years, managers have recognized that a great deal of information exchange and even decision making—perhaps the majority—occurs through the organization's innumerable informal channels and relationships. Yet this part of the management process has often been dismissed as either unimportant ("office gossip" or "rumor mill") or unmanageable ("disruptive cliques" or "unholy alliances"). In the management of transnational organizations, such biases need to be reexamined. Because organizational units are widely separated and information is scarce, not only is it more important for managers of international operations to exert some control and influence over informal systems, it is also more feasible for them to do so.

Getting started is often remarkably easy, requiring managers to do little more than use their daily involvement in the ongoing management processes to shape the nature and quality of communications patterns and relationships. Because of their nature and intensity, informal relationships respond remarkably quickly to changes in the frequency and agenda of management trips and corporate meetings, the pattern of committee assignments, and the track of people's career development. Furthermore, management can recognize, legitimize, and reinforce existing informal relationships that contribute to the corporate objective.

Developing the Organizational Psychology

In addition to an anatomy and a physiology, each organization also has a psychology (that is, a set of explicit or implicit corporate values and shared beliefs) that greatly influences the way it operates. For companies operating in an international environment, it is a particularly important organizational attribute. When employees come from a variety of different national backgrounds, management cannot assume that all will share common values and relate to common norms. Furthermore, in an operating environment in which managers are separated by distance and time barriers, shared management understanding is often a much more powerful tool than formal structures and systems for coordinating diverse activities.

Of the numerous tools and techniques that can affect an organization's psychology, our review of transnational organizations has highlighted three that are particularly important. The first is the need for a clear, shared understanding of the company's mission and objectives. Matsushita's 250-year vision of its role of promoting general welfare in a world society, Nokia's commitment to "Connecting People," and Bill Gates's aspiration to create a world with "a computer on every desk and in every home running on Microsoft software" represent variants of this approach applied at different strategic and operational levels.

The second important tool is the visible behavior and public actions of senior management. Particularly in a transnational organization in which other signals may be diluted or distorted, top management's actions speak louder than words and tend to have a powerful influence on the company's culture. They represent the clearest role model of behavior and a signal of the company's strategic and organizational priorities. When Sony Corporation founder and CEO Akio Morita relocated to New York for several years to build the company's U.S. operations personally, he sent a message about Sony's commitment to its overseas businesses that could not have been conveyed as strongly by any other means.

The third and most commonly used set of tools for modifying organizational psychology in the transnational organization is nested in the company's personnel policies, practices, and systems. A company can develop a multidimensional and flexible organization process only if its personnel systems develop and reinforce the appropriate kinds of people. At Eli Lilly, we saw a good example of such an approach. Its recruiting and promotion policies emphasized the importance of good interpersonal skills and flexible, nonparochial personalities; its career path management was used not only to develop skills and knowledge but also to broaden individual perspectives and interpersonal relationships; and its measurement and reward systems were designed to reinforce the thrust of other organization-building efforts.

Although the process of adapting an organization's culture, values, or beliefs is slow and the techniques are subtle, this tool plays a particularly important role in the development of a transnational organization, because change in the organizational anatomy and physiology without complementary modifications to its psychology can lead to severe organizational problems.

Managing the Process of Change

Particularly in the United States, many managers have assumed that organizational change is driven and dominated by changes in the formal structure. One of the most dramatic examples was Westinghouse's reorganization of its operations. Dissatisfied with its worldwide product organization, top management assigned a team of executives to study the company's international organization problems for 90 days. Its proposal that Westinghouse adopt a global matrix was accepted, and the team was then given three months to "install the new structure."

The example is far from unusual—literally hundreds of other companies have done something similar. The managers involved seemed to assume that changes in formal roles and reporting relationships would force changes in the organizational relationships and decision processes, which in turn would reshape the way individual managers think and act. This model of the process of organizational change is illustrated in Figure 4–5.

But such an approach loses sight of the real organization behind the boxes and lines on the chart. The boxes that are casually shifted around represent people with abilities, motivations, and interests, not just formal positions with specified roles. The lines that are redrawn are not just formal reporting channels but interpersonal relationships that may have taken years to develop. As a result, forcing changes in the organizational process and management mentality by altering the formal structure can have a high cost. The new relationships defined in the reorganized structure will often take months to establish at the most basic level and a year or more to become truly effective. Developing new individual attitudes and behaviors will take even longer, because many employees will be frustrated, alienated, or simply unequal to the new job requirements.

Figure 4-5 Model I: The Traditional Change Process

Change in formal structure and responsibilities
(Anatomy)
↓
Change in interpersonal relationships and processes
(Physiology)
↓
Change in individual attitudes and mentalities
(Psychology)

Most European and Japanese companies tend to adopt a very different approach in managing organizational change. Top management in these companies consciously uses personnel assignments as an important mechanism of organizational change. Building on the informal relationships that dominated their earlier management processes, European companies often use assignments and transfers to forge interpersonal links, build organizational cohesion, and develop policy consistency. And Japanese companies typically place enormous emphasis on socializing the individual into the organization and shaping his or her attitudes to conform with overall corporate values. Organizational change in these companies is often driven more by intensive education programs than by reconfigurations of the structure or systems.

Although the specific change process and sequence must vary from one company to the next, the overall process adopted in these companies to manage change is very different from the process driven by structural realignment. Indeed, the sequence is often the reverse. The first objective for many European and Japanese companies seeking major change is to influence the understanding and perceptions of key individuals. Then follows a series of changes aimed to modify the communication flows and decision-making processes. Only in a final stage are the changes consolidated and confirmed by structural realignment. This process is represented by the model in Figure 4–6. Of course, these two models of organizational change in worldwide companies are both oversimplifications of the process and overgeneralizations of national difference.

All change processes inevitably involve substantial overlap and interaction in the alterations to organizational autonomy, physiology, and psychology; the two sequences merely reflect differences in the relative emphasis on each set of tools during the process. Furthermore, though the two models reflect historical national biases, those differences seem to be eroding. American, European, and Japanese companies appear to be learning from one another.

Although the more gradual change process is much less organizationally traumatic, in times of crisis—chronic poor performance, a badly misaligned structure, or a major structural change in the environment, for example—radical restructuring may be necessary to achieve rapid and sweeping change. For most organizations, however, dramatic structural change is highly traumatic and can distract managers from their external tasks as they focus on the internal realignment. Fortunately, most change processes can be managed in a more evolutionary manner, focusing first on the modification of individual perspectives and interpersonal relationships before tackling the formal redistribution of responsibilities and power.

Figure 4–6 Model II: The Emerging Change Process

Change in individual attitudes and mentalities
↓
Change in interpersonal relationships and processes
↓
Change in formal structure and responsibilities

The Transnational Organization in Transition

During the past decade or so, political, competitive, and social pressures have reinforced the need for MNEs to create organizations that can sense and respond to complex yet often conflicting demands. Yet, as more and more companies confront the need to build worldwide organizations that are both multidimensional and flexible, the form of the transnational organization they are creating continues to adapt. Among the most widespread transnational organizational trends we have observed in recent years are a disenchantment with formal matrix structures, the redefinition of primary organizational dimensions, and the changing role of functional management in transnationals.

Disenchantment with Formal Matrix Structures

As an increasing number of managers recognized the need to develop the multidimensional organizational capabilities that characterize a transnational organization, the initial reaction of many was to impose the new model through a global matrix structure.

Widespread press coverage of ABB's decade-long global expansion through such an organization encouraged some to believe that this structure was the key to exploiting global scale efficiencies while responding to local market needs. But as many soon discovered, the strategic benefits provided by such a complex organization came at an organizational cost.

Although some companies were able to create the culture and process vital to the success of the matrix structure—in ABB's case, they supported the company's ambitious global expansion for more than a decade—others were much less successful. One such failure was Proctor and Gamble's (P&G) much publicized Organization 2005, which boldly imposed a global product structure over the company's historically successful geographic organization. The global matrix so installed created problems that eventually cost CEO Durk Jager his job.

But despite continuing nervousness about the global matrix structure, most MNEs still recognize the need to create multidimensional and flexible organizations. The big lesson of the 1990s was that such organizations are best built by developing overlaid processes and supportive cultures, not just by formalizing multiple reporting relationships. A.G. Lafley, P&G's new CEO, put it well when he said, "We built this new house, then moved in before the plumbing and wiring were connected. You cannot change organization with structure alone."

Redefinition of Key Organization Dimensions

Historically, the dominant organization dimensions around which most MNEs built their worldwide operations were business or product management on one side and country or regional management on the other. But in the past decade or so, the primary organizational characteristics that defined the transnational corporation began to change, with the global customer dimension becoming increasingly important in many worldwide organizations.

The pressure to create such customer-driven organizations grew gradually during the 1990s. First, as global customers began demanding uniform prices and service levels from their suppliers, MNEs were forced to respond by creating dedicated global account managers who would take responsibility for all sales to customers around the world.

Second, as customers expected increasing levels of value-added services, companies began to shift from "selling products" to "providing solutions." These and similar forces led to the creation of transnational organizations in which front-end, customer-facing units bundled products from back-end, product-driven units. A good example of this was IBM's Global Services Organization, one of the most successful customer-facing organizations, which grew rapidly because of its ability to supply customers with a combination of IBM's products, consulting services, and often an additional package of related, outsourced products and services.

Changing the Functional Management Role

In transnational organizations built around business, geography, and, more recently, the customer, the functional managers responsible for finance, human resources, logistics, and other cross-business and cross-organizational specialties were often relegated to secondary staff roles. However, with the expansion of the information-based, knowledge-intensive service economy, the resources and expertise that resided in these specialized functions became increasingly important sources of competitive advantage. As a result, recent years have seen their roles become increasingly important in many transnational organizations.

Managers of finance, HR, and IT functions gained importance because of their control of the scarce strategic resources that were so critical to capture and leverage on a worldwide basis. With the globalization of financial markets, for example, the finance function was often able to play a critically important role in lowering the cost of capital for the MNE. Even more dramatic has been the role of the HR experts as MNEs tapped into scarce knowledge and expertise outside the home country and leveraged it for global competitive advantage. Similarly, the recent rise of chief knowledge officers reflects the importance that many companies are placing on the organization's ability to capture and leverage valuable information, best practices, or scarce knowledge wherever it exists in the company.

Again, this trend is creating a need for transnational companies to create organizational overlays supplemented by new channels of communication and forums of decision making that enable the MNE to develop and leverage its competitive advantage through its sophisticated organizational capabilities. The form and function of the transnational organization continues to adapt as MNE managers seek new ways to develop and deliver layers of competitive advantage.

Concluding Comments

In this chapter, we have looked at the organizational capabilities that the MNE must build to operate effectively in today's fast changing global business environment. The strategic challenge, as we have described it, requires the MNE to optimize global efficiency, national responsiveness, and worldwide learning simultaneously. To deliver on this complex and conflicting set of demands, a new form of organization is required, which we call the transnational. The transnational is characterized by its legitimization of multidimensional perspectives, its distributed and interdependent capabilities, and its flexible integrative processes.

Case 4-1 Philips versus Matsushita: A New Century, a New Round

Throughout their long histories, N.V. Philips (Netherlands) and Matsushita Electric (Japan) had followed very different strategies and emerged with very different organizational capabilities. Philips built its success on a worldwide portfolio of responsive national organizations while Matsushita based its global competitiveness on its centralized, highly efficient operations in Japan.

During the 1990s, both companies experienced major challenges to their historic competitive positions and organizational models, and at the end of the decade, both companies were struggling to reestablish their competitiveness. At the start of the new millennium, new CEOs at both companies were implementing yet another round of strategic initiatives and organizational restructurings. Observers wondered how the changes would affect their long-running competitive battle.

Philips: Background

In 1892, Gerard Philips and his father opened a small light-bulb factory in Eindhoven, Holland. When their venture almost failed, they recruited Gerard's brother, Anton, an excellent salesman and manager. By 1900, Philips was the third largest light-bulb producer in Europe.

This case derives from an earlier case, "Philips versus Matsushita: Preparing for a New Round," HBS No. 399-102, prepared by Professor Christopher A. Bartlett, which was an updated version of an earlier case by Professor Bartlett and Research Associate Robert W. Lightfoot, "Philips and Matsushita: A Portrait of Two Evolving Companies," HBS Case No. 392-156. The section on Matsushita summarizes "Matsushita Electric Industrial (MEI) in 1987," HBS Case No. 388-144, by Sumantra Ghoshal (INSEAD) and Christopher A. Bartlett. Some early history on Philips draws from "Philips Group-1987," HBS Case No. 388-050, by Professors Frank Aguilar and Michael Y. Yoshino. This version was also prepared by Professor Bartlett. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

From its founding, Philips developed a tradition of caring for workers. In Eindhoven it built company houses, bolstered education, and paid its employees so well that other local employers complained. When Philips incorporated in 1912, it set aside 10% of profits for employees.

Technological Competence and Geographic Expansion While larger electrical products companies were racing to diversify, Philips made only light-bulbs. This one-product focus and Gerard's technological prowess enabled the company to create significant innovations. Company policy was to scrap old plants and use new machines or factories whenever advances were made in new production technology. Anton wrote down assets rapidly and set aside substantial reserves for replacing outdated equipment. Philips also became a leader in industrial research, creating physics and chemistry labs to address production problems as well as more abstract scientific ones. The labs developed a tungsten metal filament bulb that was a great commercial success and gave Philips the financial strength to compete against its giant rivals.

Holland's small size soon forced Philips to look beyond its Dutch borders for enough volume to mass produce. In 1899, Anton hired the company's first export manager, and soon the company was selling into such diverse markets as Japan, Australia, Canada, Brazil, and Russia. In 1912, as the electric lamp industry began to show signs of overcapacity, Philips started building sales organizations in the United States, Canada, and France. All other functions remained highly centralized in Eindhoven. In many foreign countries Philips created local joint ventures to gain market acceptance.

In 1919, Philips entered into the Principal Agreement with General Electric, giving each company the use of the other's patents. The agreement also divided the world into "three spheres of influence":

General Electric would control North America; Philips would control Holland; but both companies agreed to compete freely in the rest of the world. (General Electric also took a 20% stake in Philips.) After this time, Philips began evolving from a highly centralized company, whose sales were conducted through third parties, to a decentralized sales organization with autonomous marketing companies in 14 European countries, China, Brazil, and Australia.

During this period, the company also broadened its product line significantly. In 1918, it began producing electronic vacuum tubes; eight years later its first radios appeared, capturing a 20% world market share within a decade; and during the 1930s, Philips began producing X-ray tubes. The Great Depression brought with it trade barriers and high tariffs, and Philips was forced to build local production facilities to protect its foreign sales of these products.

Philips: Organizational Development One of the earliest traditions at Philips was a shared but competitive leadership by the commercial and technical functions. Gerard, an engineer, and Anton, a businessman, began a subtle competition where Gerard would try to produce more than Anton could sell and vice versa. Nevertheless, the two agreed that strong research was vital to Philips' survival.

During the late 1930s, in anticipation of the impending war, Philips transferred its overseas assets to two trusts, British Philips and the North American Philips Corporation; it also moved most of its vital research laboratories to Redhill in Surrey, England, and its top management to the United States. Supported by the assets and resources transferred abroad, and isolated from their parent, the individual country organizations became more independent during the war.

Because waves of Allied and German bombing had pummeled most of Philips' industrial plant in the Netherlands, the management board decided to build the postwar organization on the strengths of the national organizations (NOs). Their greatly increased self-sufficiency during the war had allowed most to become adept at responding to country-specific market conditions—a capability that became a valuable asset in the postwar era. For example, when international wrangling precluded any agreement on three competing television transmission standards (PAL, SECAM, and NTSC), each nation decided which to adopt. Furthermore, consumer preferences and economic conditions varied: in some countries, rich, furniture-encased TV sets were the norm; in others, sleek, contemporary models dominated the market. In the United Kingdom, the only way to penetrate the market was to establish a rental business; in richer countries, a major marketing challenge was overcoming elitist prejudice against television. In this environment, the independent NOs had a great advantage in being able to sense and respond to the differences.

Eventually, responsiveness extended beyond adaptive marketing. As NOs built their own technical capabilities, product development often became a function of local market conditions. For example, Philips of Canada created the company's first color TV; Philips of Australia created the first stereo TV; and Philips of the United Kingdom created the first TVs with teletext.

While NOs took major responsibility for financial, legal, and administrative matters, fourteen product divisions (PDs), located in Eindhoven, were formally responsible for development, production, and global distribution. (In reality, the NOs' control of assets and the PDs' distance from the operations often undercut this formal role.) The research function remained independent and, with continued strong funding, set up eight separate laboratories in Europe and the United States.

While the formal corporate-level structure was represented as a type of geographic/product matrix, it was clear that NOs had the real power. NOs reported directly to the management board, which Philips enlarged from 4 members to 10 to ensure that top management remained in contact with and control of the highly autonomous NOs. Each NO also regularly sent envoys to Eindhoven to represent its interests. Top management, most of whom had careers that included multiple foreign tours of duty, made frequent overseas visits to the NOs. In 1954, the board established the International

Concern Council to formalize regular meetings with the heads of all major NOs.

Within the NOs, the management structure mimicked the legendary joint technical and commercial leadership of the two Philips brothers. Most were led by a technical manager and a commercial manager. In some locations, a finance manager filled out the top management triad that typically reached key decisions collectively. This cross-functional coordination capability was reflected down through the NOs in front-line product teams, product-group–level management teams, and at the senior management committee of the NOs' top commercial, technical, and financial managers.

The overwhelming importance of foreign operations to Philips, the commensurate status of the NOs within the corporate hierarchy, and even the cosmopolitan appeal of many of the offshore subsidiaries' locations encouraged many Philips managers to take extended foreign tours of duty, working in a series of two- or three-year posts. This elite group of expatriate managers identified strongly with each other and with the NOs as a group and had no difficulty representing their strong, country-oriented views to corporate management.

Philips: Attempts at Reorganization In the late 1960s, the creation of the Common Market eroded trade barriers within Europe and diluted the rationale for maintaining independent, country-level subsidiaries. New transistor- and printed circuit-based technologies demanded larger production runs than most national plants could justify, and many of Philips' competitors were moving production of electronics to new facilities in low-wage areas in East Asia and Central and South America. Despite its many technological innovations, Philips' ability to bring products to market began to falter. In the 1960s, the company invented the audiocassette but let its Japanese competitors capture the mass market. A decade later, its R&D group developed the V2000 videocassette format—superior technically to Sony's Beta or Matsushita's VHS—but was forced to abandon it when North American Philips decided to outsource, brand, and sell a VHS product which it manufactured under license from Matsushita.

Over three decades, seven chairmen experimented with reorganizing the company to deal with its growing problems. Yet, entering the new millennium, Philips' financial performance remained poor and its global competitiveness was still in question. (See **Exhibits 1** and **2.**)

Van Reimsdijk and Rodenburg Reorganizations, 1970s Concerned about what one magazine described as "continued profitless progress," newly appointed CEO Hendrick van Riemsdijk created an organization committee to prepare a policy paper on the division of responsibilities between the PDs and the NOs. Their report, dubbed the "Yellow Booklet," outlined the disadvantages of Philips' matrix organization in 1971:

> Without an agreement [defining the relationship between national organizations and product divisions], it is impossible to determine in any given situation which of the two parties is responsible. . . . As operations become increasingly complex, an organizational form of this type will only lower the speed of reaction of an enterprise.

On the basis of this report, van Reimsdijk proposed rebalancing the managerial relationships between PDs and NOs—"tilting the matrix" in his words—to allow Philips to decrease the number of products marketed, build scale by concentrating production, and increase the flow of goods among national organizations. He proposed closing the least efficient local plants and converting the best into International Production Centers (IPCs), each supplying many NOs. In so doing, van Reimsdijk hoped that PD managers would gain control over manufacturing operations. Due to the political and organizational difficulty of closing local plants, however, implementation was slow.

In the late 1970s, his successor CEO, Dr. Rodenburg, continued this thrust. Several IPCs were established, but the NOs seemed as powerful and independent as ever. He furthered matrix simplification by replacing the dual commercial and technical leadership with single management at both the corporate and national organizational levels. Yet the power struggles continued.

Exhibit 1 Philips Group Summary Financial Data, 1970–2000 (millions of guilders unless otherwise stated)

	2000	1995	1990	1985	1980	1975	1970
Net sales	F83,437	F64,462	F55,764	F60,045	F36,536	F27,115	F15,070
Income from operations (excluding restructuring)	NA	4,090	2,260	3,075	1,577	1,201	1,280
Income from operations (including restructuring)	9,434	4,044	−2,389	N/A	N/A	N/A	N/A
As a percentage of net sales	11.3%	6.3%	−4.3%	5.1%	4.3%	4.5%	8.5%
Income after taxes	12,559	2,889	F−4,447	F1,025	F532	F341	F446
Net income from normal business operations	NA	2,684	−4,526	n/a	328	347	435
Stockholders' equity (common)	49,473	14,055	11,165	16,151	12,996	10,047	6,324
Return on stockholders' equity	42.8%	20.2%	−30.2%	5.6%	2.7%	3.6%	7.3%
Distribution per common share, per value F10 (in guilders)	F2.64	F1.60	F0.0	F2.00	F1.80	F1.40	F1.70
Total assets	86,114	54,683	51,595	52,883	39,647	30,040	19,088
Inventories as a percentage of net sales	13.9%	18.2%	20.7%	23.2%	32.8%	32.9%	35.2%
Outstanding trade receivables in month's sales	1.5	1.6	1.6	2.0	3.0	3.0	2.8
Current ratio	1.2		1.4	1.6	1.7	1.8	1.7
Employees at year-end (in thousands)	219	265	273	346	373	397	359
Wages, salaries and other related costs	NA	NA	F17,582	F21,491	F15,339	F11,212	F5,890
Exchange rate (period end; guilder/$)	2.34	1.60	1.69	2.75	2.15	2.69	3.62
Selected data in millions of dollars:							
Sales	$35,253	$40,039	$33,018	$21,802	$16,993	$10,098	$4,163
Operating profit	3,986	2,512	1,247	988	734	464	NA
Pretax income	5,837	2,083	−2,380	658	364	256	NA
Net income	5,306	1,667	−2,510	334	153	95	120
Total assets	35,885	32,651	30,549	19,202	18,440	11,186	5,273
Shareholders' equity (common)	20,238	8,784	6,611	5,864	6,044	3,741	1,747

Source: Annual reports; Standard & Poors' *Compustat;* Moody's Industrial and International Manuals.
Note: Exchange rate 12/31/00 was Euro/US$: 1.074

Exhibit 2 Philips Group, Sales by Product and Geographic Segment, 1985–2000 (millions of guilders)

	2000		1995		1990		1985	
Net Sales by Product Segment								
Lighting	F11,133	13%	F8,353	13%	F7,026	13%	F7,976	12%
Consumer electronics	32,357	39	22,027	34	25,400	46	16,906	26
Domestic appliances	4,643	6	—				6,644	10
Professional products/Systems	—	—	11,562	18	13,059	23	17,850	28
Components/Semiconductors	23,009	28	10,714	17	8,161	15	11,620	18
Software/Services	—	—	9,425	15	—	—	—	—
Medical systems	6,679	8	—	—	—	—	—	—
Origin	1,580	2	—	—	—	—	—	—
Miscellaneous	4,035	5	2,381	4	2,118	4	3,272	5
Total	83,437	100%	64,462	100%	F55,764	100%	F 64,266	100%
Operating Income by Sector								
Lighting	1,472	16%	983	24%	419	18%	F 910	30%
Consumer electronics	824	9	167	4	1,499	66	34	1
Domestic appliances	632	7	—	—	—	—	397	13
Professional products/Systems	—	—	157	4	189	8	1,484	48
Components/Semiconductors	4,220	45	2,233	55	−43	−2	44	1
Software/Services	—	—	886	22	—	—	—	—
Medical systems	372	4	—	—	—	—	—	—
Origin	2,343	25	—	—	—	—	—	—
Miscellaneous	−249	−3	423	10	218	10	200	7
Increase not attributable to a sector	−181	−2	(805)	(20)	−22	−1	6	0
Total	9,434	100%	4,044	100%	2,260	100%	F 3,075	100%

Source: Annual reports.

Notes: Conversion rate (12/31/00): 1 Euro: 2.20371 Dutch Guilders. Totals may not add due to rounding. Product sector sales after 1988 are external sales only; therefore, no eliminations are made; sector sales before 1988 include sales to other sectors; therefore, eliminations are made. Data are not comparable to consolidated financial summary due to restating.

Wisse Dekker Reorganization, 1982 Unsatisfied with the company's slow response and concerned by its slumping financial performance, upon becoming CEO in 1982, Wisse Dekker outlined a new initiative. Aware of the cost advantage of Philips' Japanese counterparts, he closed inefficient operations—particularly in Europe where 40 of the company's more than 200 plants were shut. He focused on core operations by selling some businesses (for example, welding, energy cables, and furniture) while acquiring an interest in Grundig and Westinghouse's North American lamp activities. Dekker also supported technology-sharing agreements and entered alliances in offshore manufacturing.

To deal with the slow-moving bureaucracy, he continued his predecessor's initiative to replace dual leadership with single general managers. He also continued to "tilt the matrix" by giving PDs formal product management responsibility, but leaving NOs responsible for local profits. And, he energized the management board by reducing its size, bringing on directors with strong operating experience, and creating subcommittees to deal with difficult issues. Finally, Dekker redefined the product planning process, incorporating input from the NOs, but giving global PDs the final decision on long-range direction. Still sales declined and profits stagnated.

Van der Klugt Reorganization, 1987 When Cor van der Klugt succeeded Dekker as chairman in 1987, Philips had lost its long-held consumer electronics leadership position to Matsushita, and was one of only two non-Japanese companies in the world's top ten. Its net profit margins of 1% to 2% not only lagged behind General Electric's 9%, but even its highly aggressive Japanese competitors' slim 4%. Van der Klugt set a profit objective of 3% to 4% and made beating the Japanese companies a top priority.

As van der Klugt reviewed Philips' strategy, he designated various businesses as core (those that shared related technologies, had strategic importance, or were technical leaders) and non-core (standalone businesses that were not targets for world leadership and could eventually be sold if required). Of the four businesses defined as core, three were strategically linked: components, consumer electronics, and telecommunications and data systems. The fourth, lighting, was regarded as strategically vital because its cash flow funded development. The noncore businesses included domestic appliances and medical systems which van der Klugt spun off into joint ventures with Whirlpool and GE, respectively.

In continuing efforts to strengthen the PDs relative to the NOs, van der Klugt restructured Philips around the four core global divisions rather than the former 14 PDs. This allowed him to trim the management board, appointing the displaced board members to a new policy-making Group Management Committee. Consisting primarily of PD heads and functional chiefs, this body replaced the old NO-dominated International Concern Council. Finally, he sharply reduced the 3,000-strong headquarters staff, reallocating many of them to the PDs.

To link PDs more directly to markets, van der Klugt dispatched many experienced product-line managers to Philips' most competitive markets. For example, management of the digital audio tape and electric-shaver product lines were relocated to Japan, while the medical technology and domestic appliances lines were moved to the United States.

Such moves, along with continued efforts at globalizing product development and production efforts, required that the parent company gain firmer control over NOs, especially the giant North American Philips Corp. (NAPC). Although Philips had obtained a majority equity interest after World War II, it was not always able to make the U.S. company respond to directives from the center, as the V2000 VCR incident showed. To prevent replays of such experiences, in 1987 van der Klugt repurchased publicly owned NAPC shares for $700 million.

Reflecting the growing sentiment among some managers that R&D was not market oriented enough, van der Klugt halved spending on basic research to about 10% of total R&D. To manage what he described as "R&D's tendency to ponder the fundamental laws of nature," he made R&D the

Exhibit 3 Philips Research Labs by Location and Specialty, 1987

Location	Size (staff)	Specialty
Eindhoven, The Netherlands	2,000	Basic research, electronics, manufacturing technology
Redhill, Surrey, England	450	Microelectronics, television, defense
Hamburg, Germany	350	Communications, office equipment, medical imaging
Aachen, W. Germany	250	Fiber optics, X-ray systems
Paris, France	350	Microprocessors, chip materials, design
Brussels	50	Artificial intelligence
Briarcliff Manor, New York	35	Optical systems, television, superconductivity, defense
Sunnyvale, California	150	Integrated circuits

Source: Philips, in *BusinessWeek,* March 21, 1988, p. 156.

direct responsibility of the businesses being supported by the research. This required that each research lab become focused on specific business areas (see **Exhibit 3**).

Finally, van der Klugt continued the effort to build efficient, specialized, multi-market production facilities by closing 75 of the company's 420 remaining plants worldwide. He also eliminated 38,000 of its 344,000 employees—21,000 through divesting businesses, shaking up the myth of lifetime employment at the company. He anticipated that all these restructurings would lead to a financial recovery by 1990. Unanticipated losses for that year, however—more than 4.5 billion Dutch guilders ($2.5 billion)—provoked a class-action law suit by angry American investors, who alleged that positive projections by the company had been misleading. In a surprise move, on May 14, 1990, van der Klugt and half of the management board were replaced.

Timmer Reorganization, 1990 The new president, Jan Timmer, had spent most of his 35-year Philips career turning around unprofitable businesses. With rumors of a takeover or a government bailout swirling, he met with his top 100 managers and distributed a hypothetical—but fact-based—press release announcing that Philips was bankrupt. "So what action can you take this weekend?" he challenged them.

Under "Operation Centurion," headcount was reduced by 68,000 or 22% over the next 18 months, earning Timmer the nickname "The Butcher of Eindhoven." Because European laws required substantial compensation for layoffs—Eindhoven workers received 15 months' pay, for example—the first round of 10,000 layoffs alone cost Philips $700 million. To spread the burden around the globe and to speed the process, Timmer asked his PD managers to negotiate cuts with NO managers. According to one report, however, country managers were "digging in their heels to save local jobs." But the cuts came—many from overseas operations. In addition to the job cuts, Timmer vowed to "change the way we work." He established new performance rules and asked hundreds of top managers to sign contracts that committed them to specific financial goals. Those who broke those contracts were replaced—often with outsiders.

To focus resources further, Timmer sold off various businesses including integrated circuits to Matsushita, minicomputers to Digital, defense electronics to Thomson and the remaining 53% of appliances to Whirlpool. Yet profitability was still well below the modest 4% on sales he promised. In particular, consumer electronics lagged with slow growth in a price-competitive market. The core problem was identified by a 1994 McKinsey study that estimated that value added per hour in Japanese consumer electronic factories was still 68% above that of European plants. In this environment, most NO managers kept their heads down, using their distance from Eindhoven as their defense against the ongoing rationalization.

After three years of cost-cutting, in early 1994 Timmer finally presented a new growth strategy to the board. His plan was to expand software, services, and multimedia to become 40% of revenues by 2000. He was betting on Philips' legendary innovative capability to restart the growth engines. Earlier, he had recruited Frank Carrubba, Hewlett-Packard's director of research, and encouraged him to focus on developing 15 core technologies. The list, which included interactive compact disc (CD-i), digital compact cassettes (DCC), high definition television (HDTV), and multimedia software, was soon dubbed "the president's projects." Over the next few years, Philips invested over $2.5 billion in these technologies. But Timmer's earlier divestment of some of the company's truly high-tech businesses and a 37% cut in R&D personnel left it with few who understood the technology of the new priority businesses.

By 1996, it was clear that Philips' analog HDTV technology would not become industry standard, that its DCC gamble had lost out to Sony's Minidisc, and that CD-i was a marketing failure. And while costs in Philips were lower, so too was morale, particularly among middle management. Critics claimed that the company's drive for cost-cutting and standardization had led it to ignore new worldwide market demands for more segmented products and higher consumer service.

Boonstra Reorganization, 1996 When Timmer stepped down in October 1996, the board replaced him with a radical choice for Philips—an outsider whose expertise was in marketing and Asia rather than technology and Europe. Cor Boonstra was a 58-year-old Dutchman whose years as CEO of Sara Lee, the U.S. consumer products firm, had earned him a reputation as a hard-driving marketing genius. Joining Philips in 1994, he headed the Asia Pacific region and the lighting division before being tapped as CEO.

Unencumbered by tradition, he immediately announced strategic sweeping changes designed to reach his target of increasing return on net assets from 17% to 24% by 1999. "There are no taboos, no sacred cows," he said. "The bleeders must be turned around, sold, or closed." Within three years, he had sold off 40 of Philips' 120 major businesses—including such well known units as Polygram and Grundig. He also initiated a major worldwide restructuring, promising to transform a structure he described as "a plate of spaghetti" into "a neat row of asparagus." He said:

> How can we compete with the Koreans? They don't have 350 companies all over the world. Their factory in Ireland covers Europe and their manufacturing facility in Mexico serves North America. We need a more structured and simpler manufacturing and marketing organization to achieve a cost pattern in line with those who do not have our heritage. This is still one of the biggest issues facing Philips.

Within a year, 3,100 jobs were eliminated in North America and 3,000 employees were added in Asia Pacific, emphasizing Boonstra's determination to shift production to low-wage countries and his broader commitment to Asia. And after three years, he had closed 100 of the company's 356 factories worldwide. At the same time, he replaced the company's 21 PDs with 7 divisions, but shifted day-to-day operating responsibility to 100 business units, each responsible for its profits worldwide. It was a move designed to finally eliminate the old PD/NO matrix. Finally, in a move that shocked most employees, he announced that the 100-year-old Eindhoven headquarters would be relocated to Amsterdam with only 400 of the 3000 corporate positions remaining.

By early 1998, he was ready to announce his new strategy. Despite early speculation that he might abandon consumer electronics, he proclaimed it as the center of Philips' future. Betting on the "digital revolution," he planned to focus on established technologies such as cellular phones (through a joint venture with Lucent), digital TV, digital videodisc, and web TV. Furthermore, he committed major resources to marketing, including a 40% increase in advertising to raise awareness and image of the Philips brand and de-emphasize most of the 150 other brands it supported worldwide—from Magnavox TVs to Norelco shavers to Marantz stereos.

While not everything succeeded (the Lucent cell phone JV collapsed after nine months, for example), overall performance improved significantly in the late 1990s. By 2000, Boonstra was able to announce that he had achieved his objective of a 24% return on net assets.

Kleisterlee Reorganization, 2001 In May 2001, Boonstra passed the CEO's mantle to Gerard Kleisterlee, a 54-year-old engineer (and career Philips man) whose turnaround of the components business had earned him a board seat only a year earlier. Believing that Philips had finally turned around, the board challenged Kleisterlee to grow sales by 10% annually and earnings 15%, while increasing return on assets to 30%.

Despite its stock trading at a steep discount to its breakup value, Philips' governance structure and Dutch legislation made a hostile raid all but impossible. Nonetheless, Kleisterlee described the difference as "a management discount" and vowed to eliminate it. "Our fragmented organization makes us carry costs that are too high," he said. "In some production activities where we cannot add value, we will outsource and let others do it for us."

The first sign of restructuring came within weeks, when mobile phone production was outsourced to CEC of China. Then, in August, Kleisterlee announced an agreement with Japan's Funai Electric to take over production of its VCRs, resulting in the immediate closure of the European production center in Austria and the loss of 1,000 jobs. The CEO acknowledged that he was seeking partners to take over the manufacturing of some of its other mass-produced items such as television sets.

But by 2001, a slowing economy resulted in the company's first quarterly loss since 1996, and by year's end the loss had grown to 2.6 billion euros compared to the previous year's 9.6 billion profit. Many felt that these growing financial pressures—and shareholders' growing impatience—were finally leading Philips to recognize that its best hope of survival was to outsource even more of its basic manufacturing and become a technology developer and global marketer. They believed it was time to recognize that its 30-year quest to build efficiency into its global operations had failed.

Matsushita: Background

In 1918, Konosuke Matsushita (or "KM" as he was affectionately known), a 23-year-old inspector with the Osaka Electric Light Company, invested ¥100 to start production of double-ended sockets in his modest home. The company grew rapidly, expanding into battery-powered lamps, electric irons, and radios. On May 5, 1932, Matsushita's 14th anniversary, KM announced to his 162 employees a 250-year corporate plan broken into 25-year sections, each to be carried out by successive generations. His plan was codified in a company creed and in the "Seven Spirits of Matsushita" (see **Exhibit 4**), which, along with the company song, continued to be woven into morning assemblies worldwide and provided the basis of the "cultural and spiritual training" all new employees received during their first seven months with the company.

In the post-war boom, Matsushita introduced a flood of new products: TV sets in 1952; transistor radios in 1958; color TVs, dishwashers, and electric ovens in 1960. Capitalizing on its broad line of 5,000 products (Sony produced 80), the company opened 25,000 domestic retail outlets. With more than six times the outlets of rival Sony, the ubiquitous "National Shops" represented 40% of appliance stores in Japan in the late 1960s. These not only provided assured sales volume, but also gave the company direct access to market trends and consumer reaction. When post-war growth slowed,

Exhibit 4 Matsushita Creed and Philosophy (Excerpts)

Creed

Through our industrial activities, we strive to foster progress, to promote the general welfare of society, and to devote ourselves to furthering the development of world culture.

Seven Spirits of Matsushita

Service through Industry
Fairness
Harmony and Cooperation
Struggle for Progress
Courtesy and Humility
Adjustment and Assimilation
Gratitude

KM's Business Philosophy (Selected Quotations)

"The purpose of an enterprise is to contribute to society by supplying goods of high quality at low prices in ample quantity."

"Profit comes in compensation for contribution to society. . . . [It] is a result rather than a goal."

"The responsibility of the manufacturer cannot be relieved until its product is disposed of by the end user."

"Unsuccessful business employs a wrong management. You should not find its causes in bad fortune, unfavorable surroundings, or wrong timing."

"Business appetite has no self-restraining mechanism. . . . When you notice you have gone too far, you must have the courage to come back."

Source: "Matsushita Electric Industrial (MEI) in 1987," Harvard Business School Case No. 388-144.

however, Matsushita had to look beyond its expanding product line and excellent distribution system for growth. After trying many tactics to boost sales—even sending assembly line workers out as door-to-door salesmen—the company eventually focused on export markets.

The Organization's Foundation: Divisional Structure Plagued by ill health, KM wished to delegate more authority than was typical in Japanese companies. In 1933, Matsushita became the first Japanese company to adopt the divisional structure, giving each division clearly defined profit responsibility for its product. In addition to creating a "small business" environment, the product division structure generated internal competition that spurred each business to drive growth by leveraging its technology to develop new products. After the innovating division had earned substantial profits on its new product, however, company policy was to spin it off as a new division to maintain the "hungry spirit."

Under the "one-product-one-division" system, corporate management provided each largely self-sufficient division with initial funds to establish its own development, production, and marketing capabilities. Corporate treasury operated like a commercial bank, reviewing divisions' loan requests for which it charged slightly higher-than-market interest, and accepting deposits on their excess funds. Divisional profitability was determined after deductions for central services such as corporate R&D and interest on internal borrowings. Each division paid 60% of earnings to headquarters and financed all additional working capital and fixed asset requirements from the retained 40%. Transfer prices were based on the market and settled through the treasury on normal commercial terms. KM expected uniform performance across the company's 36 divisions, and division managers whose operating profits fell below 4% of sales for two successive years were replaced.

While basic technology was developed in a central research laboratory (CRL), product development and engineering occurred in each of the product divisions. Matsushita intentionally under-funded the CRL, forcing it to compete for additional funding from the divisions. Annually, the CRL publicized its major research projects to the product divisions, which then provided funding in exchange for technology for marketable applications. While it was rarely the innovator, Matsushita was usually very fast to market—earning it the nickname "Manishita," or copycat.

Matsushita: Internationalization Although the establishment of overseas markets was a major thrust of the second 25 years in the 250-year plan, in an overseas trip in 1951 KM had been unable to find any American company willing to collaborate with Matsushita. The best he could do was a technology exchange and licensing agreement with Philips. Nonetheless, the push to internationalize continued.

Expanding Through Color TV In the 1950s and 1960s, trade liberalization and lower shipping rates made possible a healthy export business built on black and white TV sets. In 1953, the company opened its first overseas branch office—the Matsushita Electric Corporation of America (MECA). With neither a distribution network nor a strong brand, the company could not access traditional retailers, and had to resort to selling its products under their private brands through mass merchandisers and discounters.

During the 1960s, pressure from national governments in developing countries led Matsushita to open plants in several countries in Southeast Asia and Central and South America. As manufacturing costs in Japan rose, Matsushita shifted more basic production to these low-wage countries, but almost all high-value components and subassemblies were still made in its scale-intensive Japanese plants. By the 1970s, projectionist sentiments in the West forced the company to establish assembly operations in the Americas and Europe. In 1972, it opened a plant in Canada; in 1974, it bought Motorola's TV business and started manufacturing its Quasar brand in the United States; and in 1976, it built a plant in Cardiff, Wales, to supply the Common Market.

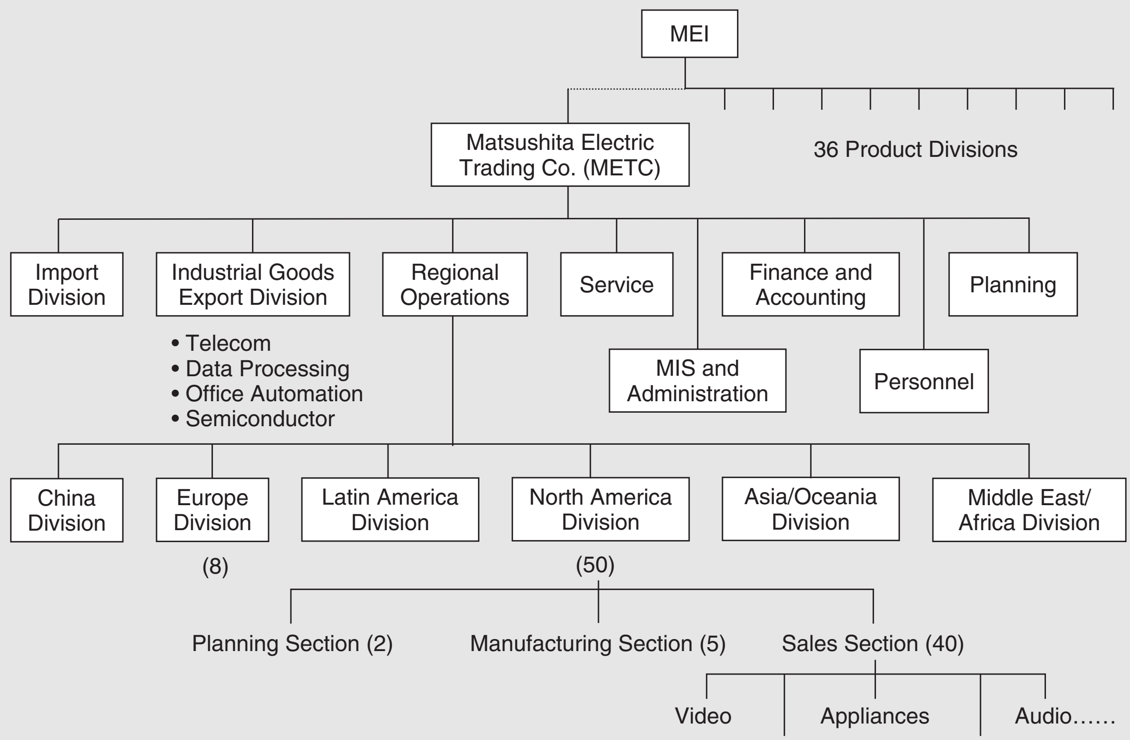
Building Global Leadership Through VCRs The birth of the videocassette recorder (VCR) propelled Matsushita into first place in the consumer electronics industry during the 1980s. Recognizing the potential mass-market appeal of the VCR—developed by Californian broadcasting company, Ampex, in 1956—engineers at Matsushita began developing VCR technology. After six years of development work, Matsushita launched its commercial broadcast video recorder in 1964, and introduced a consumer version two years later.

In 1975, Sony introduced the technically superior "Betamax" format, and the next year JVC launched a competing "VHS" format. Under pressure from MITI, the government's industrial planning ministry, Matsushita agreed to give up its own format and adopt the established VHS standard. During Matsushita's 20 years of VCR product development, various members of the VCR research team spent most of their careers working together, moving from central labs to the product divisions' development labs and eventually to the plant.

The company quickly built production to meet its own needs as well as those of OEM customers like GE, RCA, and Zenith, who decided to forego self-manufacture and outsource to the low-cost Japanese. Between 1977 and 1985, capacity increased 33-fold to 6.8 million units. (In parallel, the company aggressively licensed the VHS format to other manufacturers, including Hitachi, Sharp, Mitsubishi and, eventually, Philips.) Increased volume enabled Matsushita to slash prices 50% within five years of product launch, while simultaneously improving quality. By the mid-1980s, VCRs accounted for 30% of total sales—over 40% of overseas revenues—and provided 45% of profits.

Changing Systems and Controls In the mid-1980s, Matsushita's growing number of overseas companies reported to the parent in one of two ways: wholly owned, single-product global plants reported directly to the appropriate product division, while overseas sales and marketing subsidiaries and overseas companies producing a broad product line for local markets reported to Matsushita Electric Trading Company (METC), a separate legal entity. (See **Exhibit 5** for METC's organization.)

Exhibit 5 Organization of METC, 1985



Source: Harvard Business School case No. 388-144.
Note: ( ) = number of people.

Throughout the 1970s, the central product divisions maintained strong operating control over their offshore production units. Overseas operations used plant and equipment designed by the parent company, followed manufacturing procedures dictated by the center, and used materials from Matsushita's domestic plants. Growing trends toward local sourcing, however, gradually weakened the divisions' direct control. By the 1980s, instead of controlling inputs, they began to monitor measures of output (for example, quality, productivity, inventory levels).

About the same time, product divisions began receiving the globally consolidated return on sales reports that had previously been consolidated in METC statements. By the mid-1980s, as worldwide planning was introduced for the first time, corporate management required all its product divisions to prepare global product strategies.

Headquarters–Subsidiary Relations Although METC and the product divisions set detailed sales and profits targets for their overseas subsidiaries, local managers were told they had autonomy on how to achieve the targets. "Mike" Matsuoko, president of the company's largest European production subsidiary in Cardiff, Wales, however, emphasized that failure to meet targets forfeited freedom: "Losses show bad health and invite many doctors from Japan, who provide advice and support."

In the mid-1980s, Matsushita had over 700 expatriate Japanese managers and technicians on foreign assignment for four to eight years, but defended that high number by describing their pivotal role. "This vital communication role," said one manager, "almost always requires a manager from the parent company. Even if a local manager speaks Japanese, he would not have the long experience that is needed to build relationships and understand our management processes."

Expatriate managers were located throughout foreign subsidiaries, but there were a few positions that were almost always reserved for them. The most visible were subsidiary general managers whose main role was to translate Matsushita philosophy abroad. Expatriate accounting managers were expected to "mercilessly expose the truth" to corporate headquarters; and Japanese technical managers were sent to transfer product and process technologies and provide headquarters with local market information. These expatriates maintained relationships with senior colleagues at headquarters, who acted as career mentors, evaluated performance (with some input from local managers), and provided expatriates with information about parent company developments.

General managers of foreign subsidiaries visited Osaka headquarters at least two or three times each year—some as often as every month. Corporate managers reciprocated these visits, and on average, major operations hosted at least one headquarters manager each day of the year. Face-to-face meetings were considered vital: "Figures are important," said one manager, "but the meetings are necessary to develop judgment." Daily faxes and nightly phone calls between headquarters and expatriate colleagues were a vital management link.

Yamashita's Operation Localization Although international sales kept rising, as early as 1982 growing host country pressures caused concern about the company's highly centralized operations. In that year, newly appointed company President Toshihiko Yamashita launched "Operation Localization" to boost offshore production from less than 10% of value-added to 25%, or half of overseas sales, by 1990. To support the target, he set out a program of four localizations—personnel, technology, material, and capital.

Over the next few years, Matsushita increased the number of local nationals in key positions. In the United States, for example, U.S. nationals became the presidents of three of the six local companies, while in Taiwan the majority of production divisions were replaced by Chinese managers. In each case, however, local national managers were still supported by senior Japanese advisors, who maintained a direct link with the parent company. To localize technology and materials, the company developed its national subsidiaries' expertise to source equipment locally, modify designs to meet local requirements, incorporate local components, and adapt corporate processes and technologies to accommodate these changes. And by the mid-1980s, offshore production subsidiaries were free to buy minor parts from local vendors as long as quality could be assured, but still had to buy key components from internal sources.

One of the most successful innovations was to give overseas sales subsidiaries more choice over the products they sold. Each year the company held a two-week internal merchandising show and product planning meeting where product divisions exhibited the new lines. Here, overseas sales subsidiary managers described their local market needs and negotiated for change in features, quantities, and even prices of the products they wanted to buy. Product division managers, however, could overrule the sales subsidiary if they thought introduction of a particular product was of strategic importance.

President Yamashita's hope was that Operation Localization would help Matsushita's overseas companies develop the innovative capability and entrepreneurial initiatives that he had long admired in the national organizations of rival Philips. (Past efforts to develop such capabilities abroad had failed. For example, when Matsushita acquired Motorola's TV business in the United States, its highly innovative technology group atrophied as

American engineers resigned in response to what they felt to be excessive control from Japan's highly centralized R&D operations.) Yet despite his four localizations, overseas companies continued to act primarily as the implementation arms of central product divisions. In an unusual act for a Japanese CEO, Yamashita publicly expressed his unhappiness with the lack of initiative at the TV plant in Cardiff. Despite the transfer of substantial resources and the delegation of many responsibilities, he felt that the plant remained too dependent on the center.

Tanii's Integration and Expansion Yamashita's successor, Akio Tanii, expanded on his predecessor's initiatives. In 1986, feeling that Matsushita's product divisions were not giving sufficient attention to international development—in part because they received only 3% royalties for foreign production against at least 10% return on sales for exports from Japan—he brought all foreign subsidiaries under the control of METC. Tanii then merged METC into the parent company in an effort to fully integrate domestic and overseas operations. Then, to shift operational control nearer to local markets, he relocated major regional headquarters functions from Japan to North America, Europe, and Southeast Asia. Yet still he was frustrated that the overseas subsidiary companies acted as little more than the implementing agents of the Osaka-based product divisions.

Through all these changes, however, Matsushita's worldwide growth continued generating huge reserves. With $17.5 billion in liquid financial assets at the end of 1989, the company was referred to as the "Matsushita Bank," and several top executives began proposing that if they could not develop innovative overseas companies, they should buy them. Flush with cash and international success, in early 1991 the company acquired MCA, the U.S. entertainment giant, for $6.1 billion with the objective of obtaining a media software source for its hardware. Within a year, however, Japan's bubble economy had burst, plunging the economy into recession. Almost overnight, Tanii had to shift the company's focus from expansion to cost containment. Despite his best efforts to cut costs, the problems ran too deep. With 1992 profits less than half their 1991 level, the board took the unusual move of forcing Tanii to resign in February 1993.

Morishita's Challenge and Response At 56, Yoichi Morishita was the most junior of the company's executive vice presidents when he was tapped as the new president. Under the slogan "simple, small, speedy and strategic," he committed to cutting headquarters staff and decentralizing responsibility. Over the next 18 months, he moved 6,000 staff to operating jobs. In a major strategic reversal, he also sold 80% of MCI to Seagram, booking a $1.2 billion loss on the transaction.

Yet the company continued to struggle. Japan's domestic market for consumer electronics collapsed—from $42 billion in 1989 to $21 billion in 1999. Excess capacity drove down prices and profits evaporated. And although offshore markets were growing, the rise of new competition—first from Korea, then China—created a global glut of consumer electronics, and prices collapsed.

With a strong yen making exports from Japan uncompetitive, Matsushita's product divisions rapidly shifted production offshore during the 1990s, mostly to low-cost Asian countries like China and Malaysia. By the end of the decade, its 160 factories outside Japan employed 140,000 people—about the same number of employees as in its 133 plants in Japan. Yet, despite the excess capacity and strong yen, management seemed unwilling to radically restructure its increasingly inefficient portfolio of production facilities or even lay off staff due to strongly-held commitments to lifetime employment. Despite Morishita's promises, resistance within the organization prevented his implementation of much of the promised radical change.

In the closing years of the decade, Morishita began emphasizing the need to develop more of its technology and innovation offshore. Concerned that only 250 of the company's 3,000 R&D scientists and engineers were located outside Japan, he began investing in R&D partnerships and technical exchanges, particularly in fast emerging fields. For example, in 1998 he signed a joint R&D agreement with the Chinese Academy of Sciences, China's leading research organization. Later that year, he announced the establishment of the Panasonic Digital Concepts Center in California. Its mission was to act as a venture fund and an incubation center for the new ideas and technologies emerging in Silicon Valley. To some it was an indication that Matsushita had given up trying to generate new technology and business initiatives from its own overseas companies.

Nakamura's Initiatives In April 2000, Morishita became chairman and Kunio Nakamura replaced him as president. Profitability was at 2.2% of sales, with consumer electronics at only 0.4%, including losses generated by one-time cash cows, the TV and VCR divisions. (**Exhibits 6 and 7** provide the financial history for Matsushita and key product lines.) The new CEO vowed to raise this to 5% by 2004. Key to his plan was to move Matsushita beyond its

Exhibit 6 Matsushita, Summary Financial Data, 1970–2000[a]

	2000	1995	1990	1985	1980	1975	1970
In billions of yen and percent:							
Sales	¥7,299	¥6,948	¥6,003	¥5,291	¥2,916	¥1,385	¥932
Income before tax	219	232	572	723	324	83	147
As % of sales	3.0%	3.3%	9.5%	13.7%	11.1%	6.0%	15.8%
Net income	¥100	¥90	¥236	¥216	¥125	¥32	¥70
As % of sales	1.4%	1.3%	3.9%	4.1%	4.3%	2.3%	7.6%
Cash dividends (per share)	¥14.00	¥13.50	¥10.00	¥ 9.52	¥7.51	¥6.82	¥6.21
Total assets	7,955	8,202	7,851	5,076	2,479	1,274	735
Stockholders' equity	3,684	3,255	3,201	2,084	1,092	573	324
Capital investment	355	316	355	288	NA	NA	NA
Depreciation	343	296	238	227	65	28	23
R&D	526	378	346	248	102	51	NA
Employees (units)	290,448	265,397	198,299	175,828	107,057	82,869	78,924
Overseas employees	143,773	112,314	59,216	38,380	NA	NA	NA
As % of total employees	50%	42%	30%	22%	NA	NA	NA
Exchange rate (fiscal period end; ¥/$)	103	89	159	213	213	303	360
In millions of dollars:							
Sales	$68,862	$78,069	$37,753	$24,890	$13,690	$4,572	$2,588
Operating income before depreciation	4,944	6,250	4,343	3,682	1,606	317	NA
Operating income after depreciation	1,501	2,609	2,847	2,764	1,301	224	NA
Pretax income	2,224	2,678	3,667	3,396	1,520	273	408
Net income	941	1,017	1,482	1,214	584	105	195
Total assets	77,233	92,159	49,379	21,499	11,636	4,206	2,042
Total equity	35,767	36,575	20,131	10,153	5,129	1,890	900

Source: Annual reports; Standard & Poors' *Compustat;* Moody's Industrial and International Manuals.

[a] Data prior to 1987 are for the fiscal year ending November 20; data 1988 and after are for the fiscal year ending March 31.

Exhibit 7 Matsushita, Sales by Product and Geographic Segment, 1985–2000 (billion yen)

	2000		1995		FY 1990		FY 1985	
By Product Segment:								
Video and audio equipment	¥1,706	23%	¥1,827	26%	¥2,159	36%	¥2,517	48%
Home appliances and household equipment	1,306	18	—	—	—	—	—	—
Home appliances	—	—	916	13	802	13	763	14
Communication and industrial equipment	—	—	1,797	26	1,375	23	849	16
Electronic components	—	—	893	13	781	13	573	11
Batteries and kitchen-related equipment	—	—	374	4	312	5	217	4
Information and communications equipment	2,175	28	—	—	—	—	—	—
Industrial equipment	817	11	—	—	—	—	—	—
Components	1,618	21	—	—	—	—	—	—
Others	—	—	530	8	573	10	372	7
Total	¥7,682	100%	¥6,948	100%	¥6,003	100%	¥5,291	100%
By Geographic Segment:								
Domestic	¥3,698	51%	¥3,455	50%	¥3,382	56%	¥2,659	50%
Overseas	3,601	49	3,493	50	2,621	44	2,632	50

Source: Annual reports.
Notes: Total may not add due to rounding.

roots as a "super manufacturer of products" and begin "to meet customer needs through systems and services." He planned to flatten the hierarchy and empower employees to respond to customer needs, and as part of the implementation, all key headquarters functions relating to international operations were transferred to overseas regional offices.

But the biggest shock came in November, when Nakamura announced a program of "destruction and creation," in which he disbanded the product division structure that KM had created as Matsushita's basic organizational building block 67 years earlier. Plants, previously controlled by individual product divisions, would now be integrated into multi-product production centers. In Japan alone 30 of the 133 factories were to be consolidated or closed. And marketing would shift to two corporate marketing entities, one for Panasonic brands (consumer electronics, information and communications products) and one for national branded products (mostly home appliances).

In February, 2001, just three months after raising his earnings estimate for the financial year ending March 2001, Nakamuta was embarrassed to readjust his estimate sharply downward. As Matsushita's first losses in 30 years accelerated, the new CEO announced a round of emergency measures designed to cut costs. When coupled with the earlier structural changes, these were radical moves, but in a company that even in Japan was being talked about as a takeover target, observers wondered if they were sufficient to restore Matsushita's tattered global competitiveness.

Case 4-2 Rudi Gassner and the Executive Committee of BMG International (A)

Rudi Gassner, CEO of BMG International, paused and glanced around the hotel suite at the members of his executive committee. They were not coming to any consensus on the issue at hand. It was May 1993 and the BMG International executive committee was gathered for one of its quarterly meetings, this time in Boca Raton, Florida, during the annual Managing Directors Convention.

Gassner had just congratulated Arnold Bahlmann, a regional director and executive committee member, on his recent negotiation of a reduced manufacturing transfer price for the upcoming year's production of CDs, records, and cassettes. Because business plans for the year had been established in March based on the assumption of a higher manufacturing cost, the new price would realize an unanticipated savings of roughly $20 million.

As a result of these savings, the executive committee now faced some tough decisions. First, they had to decide whether or not to change the business targets for each country to reflect the new manufacturing price. If they chose to alter the targets, they had to address the even more delicate matter of whether managing directors' bonuses, which were based principally on the achievement of these targets, should be based on the old or new figures.

Gassner had already discussed this issue with Bahlmann and CFO Joe Gorman, who had run calculations on the impact of the new price for each operating company. These had been distributed to the executive committee before the meeting. Through previous discussions and evaluation of the financial impact, Gassner had formulated his opinion about what should be done.

In his mind, the issues were clear. BMG International had achieved tremendous success and growth in its short lifetime of six years, and the regional directors (RDs) and managing directors (MDs)[1] had every right to feel good about their exceptional performance. (See **Exhibits 1** and **2** for company organization charts.) But now Gassner wanted to guard against the company becoming a victim of its own success. He knew that they would have to carefully monitor the economics of the business and maintain their agility in order to meet the challenges of the future. In light of these concerns, Gassner felt that the MDs should be held accountable for the savings from the reduced manufacturing price. The executive committee needed seriously to consider not only adjusting the targets, but also the bonus basis. As he explained, "It seemed fair to me. These were windfall profits coming to the managing directors, and they didn't even have to lift a finger to get them. I didn't want them to become complacent during the year."

The executive committee, however, seemed unwilling even to entertain this possibility. Gassner suspected that some of the RDs were taking the "path of least resistance" because they did not want to return to their MDs and announce that the bonus targets had been changed. His frustration mounting, Gassner wondered if he should drop the issue for now or provoke them by saying what was on his mind: "Listen guys, you're thinking too much like MDs. You should be thinking about what is good for the whole company."

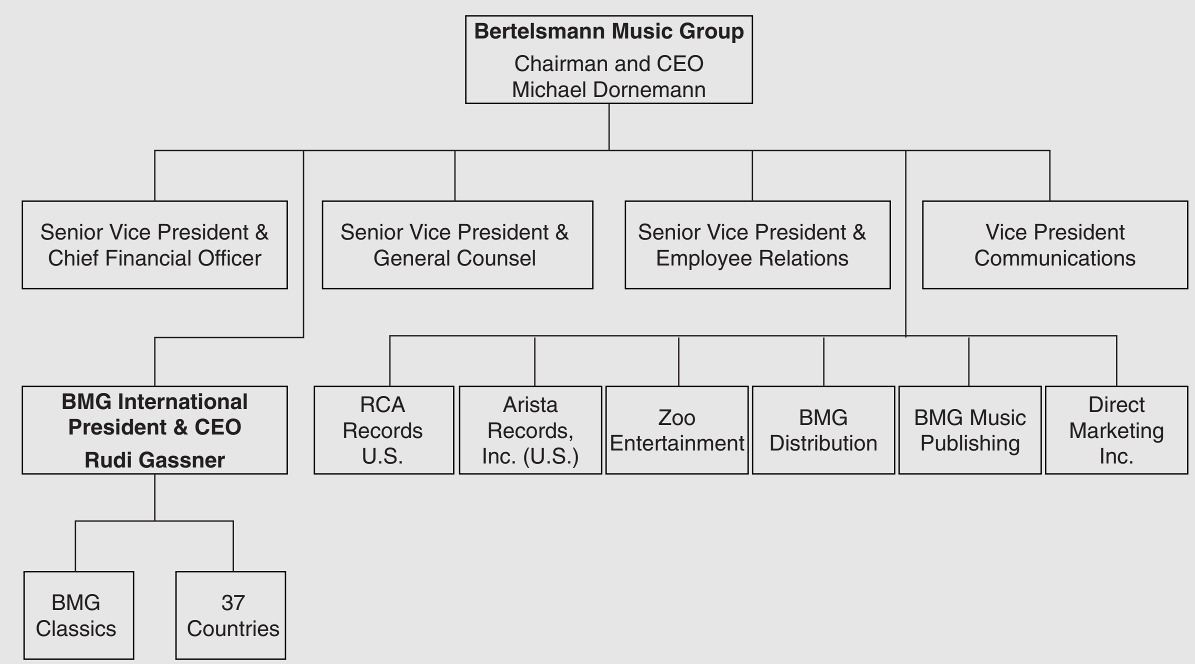
Company Background

BMG International was a subsidiary of Bertelsmann AG, a German media conglomerate with over 200 companies and 50,000 employees operating in

Research Associate Katherine Seger Weber prepared this case under the supervision of Professor Linda A. Hill as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

[1]Managing Directors managed local operations in a particular country; each MD reported to one of five Regional Directors.

Exhibit 1 Bertelsmann Music Group Organization Chart



37 countries. Founded in 1835 as a lithographic printing company in Guetersloh, Germany, Bertelsmann's interests had grown to include businesses in music, film, television, radio, book, magazine, and newspaper publishing and distribution, as well as printing and manufacturing operations. Still headquartered in the small rural town, Bertelsmann had become the second-largest media enterprise in the world, with 1992 sales of $9.7 billion.

Bertelsmann's corporate charter mandated autonomous business divisions and entrepreneurial operating management, and emphasized respect for the cultural traditions of each country in which it operated. Each business unit had its own, usually local, entrepreneurial management with operating control over its business plan, the development of its assets, its human resources, and its contribution to overall profitability. Delegation of responsibility and authority was supported by performance-linked compensation for managers and profit-sharing by all employees.

In 1986, Bertelsmann entered the U.S. market with its purchases of Doubleday and Dell, two large publishing houses, and RCA Records, which had made music history with Elvis Presley in the 1950s. On acquiring RCA, Bertelsmann organized its worldwide music holdings—which also included the American record label Arista, the German label Ariola, and various smaller labels and music publishing and marketing operations—into the Bertelsmann Music Group (BMG). With RCA, BMG entered the ranks of the "Big Six" record companies—CBS, Warner, BMG, Capitol-EMI, PolyGram, and MCA—which supplied 80% of worldwide music sales.[2]

BMG was headquartered in New York under German Chairman and CEO Michael Dornemann, who split the company's operations into two divisions: the United States and the rest of the world. In

[2]Purkiss, Alan, "Let's Hear It for the Unsung Hero," *Accountancy*, June 1992, pp. 70–73.

Exhibit 2 BMG International Organization Chart, 1993

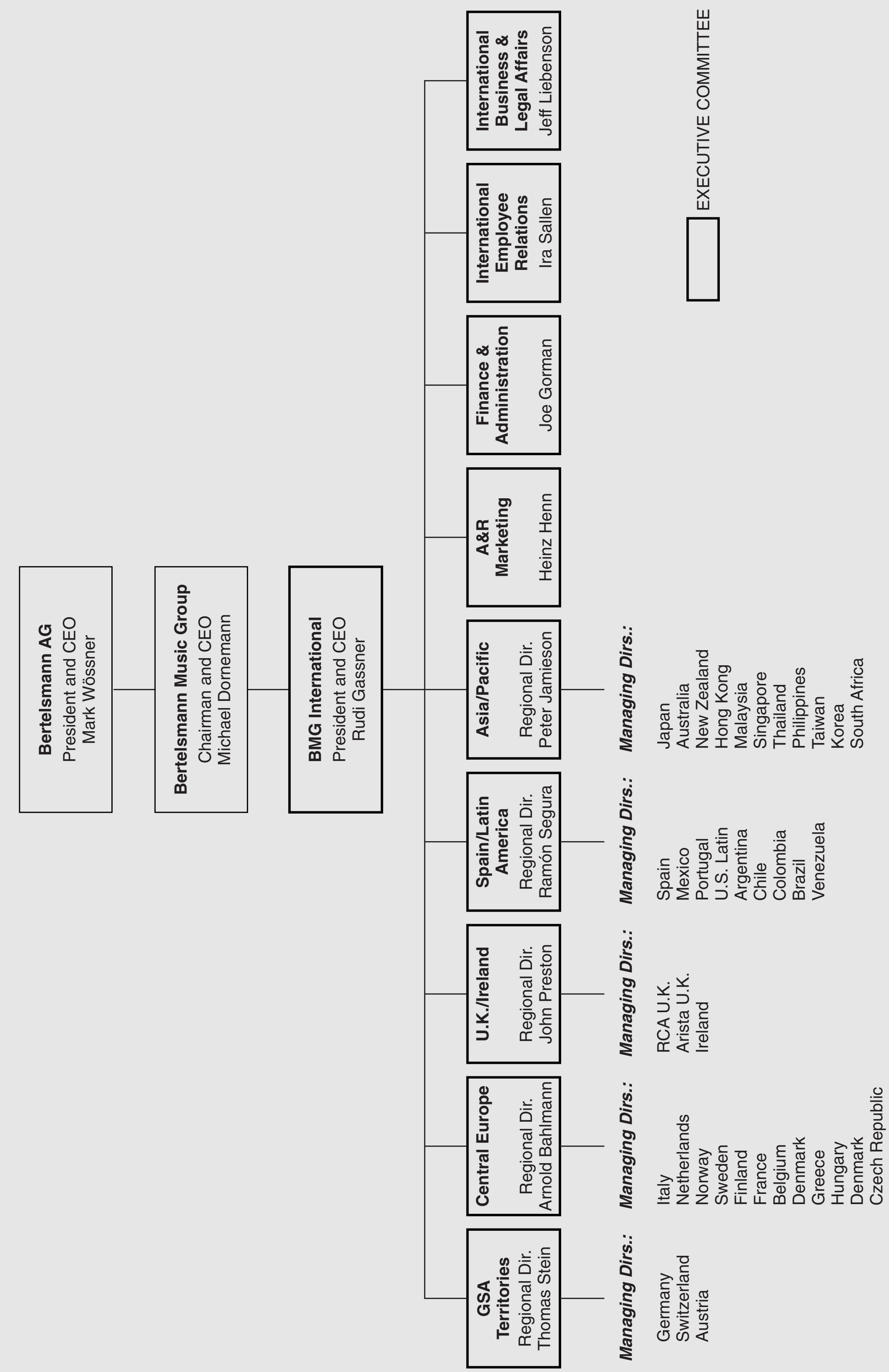


Exhibit 3 Rudi Gassner Career Highlights

Rudi Gassner

President and CEO, BMG International

German, 51 years old

• 1984–1987:	Executive VP, PolyGram International, London
• 1983–1984:	President, Polydor International (PolyGram), Hamburg
• 1980–1983:	President, Deutsche Grammophon (PolyGram), Hamburg
• Fall 1979:	Harvard Business School Program for Management Development (PMD)
• 1977–1980:	Managing Director, Metronome (PolyGram), Hamburg
• 1969–1977:	Sales Manager, Deutsche Grammophon (PolyGram), Munich
• 1964–1969:	Music Wholesaling, Munich

the United States, BMG's priority was to stem the losses from RCA (which posted a $35 million deficit in 1987) and build market share for the flagging U.S. labels.[3]

With BMG's overseas holdings, Dornemann formed an international division and hired German-born Rudi Gassner, then executive vice president of PolyGram International, as president and CEO (see **Exhibit 3**). According to Dornemann, Gassner "had the right background in the music business and the right international experience. He best fit the leadership qualities we were looking for."[4] At its inception in 1987, the international division, also headquartered in New York, comprised operations in 17 countries across the globe. Gassner described the fledgling organization as "a patchwork of companies around the world. It had no mission, no goals, and in total, it didn't make any money. . . . The only way from there was up."[5]

In his first six years, Gassner led the company, which he named BMG International, through a tremendous period of growth. By launching new satellite companies, purchasing small labels, and forming joint ventures, BMG International's presence had expanded by 1993 to include 37 countries. Sales had increased an average of 20% annually, reaching $2 billion in 1993 (two-thirds of BMG's overall revenue that year). International market share, which was near 11% in 1987, was a healthy 17%, and as high as 25% in some territories.[6]

BMG International was responsible for marketing and distributing top-selling U.S. artists such as Whitney Houston and Kenny G across the globe.[7] In addition, the company developed such artists as Annie Lennox and Lisa Stansfield (Britain) and Eros Ramazzotti (Italy) in their local territories to be marketed worldwide. On a local level, groups such as B'z (Japan) and Bronco (Mexico) were extremely successful, selling in excess of 1 million units in their respective countries. The company also had extensive classics and jazz catalogues, with artists such as James Galway and Antonio Hart. (See **Exhibit 4** for roster of top-selling artists.)[8]

Rudi Gassner and BMG International

In 1987, at the age of 45, Gassner became the CEO of the newly-formed BMG International. "It was a once-in-a-lifetime opportunity," he reflected, "to build what I think a global company should look

[3]Dannen, Frederick, *Hit Men: Power Brokers and Fast Money Inside the Music Business* (New York: Vintage Books, 1991), pp. 246–261.

[4]"BMG's Five Year Man," *Music Business International*, Vol. 3, No. 1 (January 1993), p. 18.

[5]Ibid.

[6]According to Gassner, a 1% worldwide market share gain was worth around $250 million in revenue. ("Charting the Future" speech, May 1993, Boca Raton, Florida.)

[7]The "prestige market" of the U.S. was the most important supplier of recorded music around the world, and BMG's Arista, led by long-time music executive Clive Davis, had launched two global superstars, Whitney Houston and Kenny G, who reached No. 1 and 2 on the *Billboard* album chart. In 1993, Houston's soundtrack for *The Bodyguard* sold 20 million copies and became one of the top-selling albums of all time, fueling a significant portion of BMG's revenue in the U.S. and abroad. (Lander, Mark, "An Overnight Success—After Six Years," *Business Week*, April 19, 1993, pp. 52–54.)

[8]In addition, BMG International had an agreement with MCA/Geffen to market and distribute that company's products outside the U.S. The MCA/Geffen deal gave BMG International access to such stars as Guns 'N' Roses, Nirvana, Aerosmith, Bobby Brown, and Cher.

Exhibit 4 Selected BMG International Top-Selling Artists, 1993

Artist	Country of Origin	Units Sold 1992/1993 (in thousands)
Global Superstars:		
Whitney Houston	United States	11,800
Kenny G	United States	2,200
Annie Lennox	United Kingdom	1,200
David Bowie	United Kingdom	700
SNAP	Germany	700
Dr. Alban	Germany	600
Regional Superstars:		
Vaya Con Dios	Belgium	1,300
Juan Luis Guerra	Spain	1,100
Eros Ramazzotti	Italy	1,100
Die Prinzen	Germany	900
Take That	United Kingdom	700
Bonnie Tyler	Germany	500
Local Superstars:		
B'z	Japan	5,700
Bronco	Mexico	1,300
Joaquin Sabina	Spain	500
Jos Jos	Mexico	400
Lucio Dalla	Italy	250

like." When he arrived at BMG, Gassner adapted quickly to the Bertelsmann culture. "My 17 years at PolyGram gave me the experience to run a global business; that was my know-how," he explained. "But on the other hand, I very much liked the Bertelsmann style. It was very close to my personal style." One of his colleagues at BMG described Gassner's transition:

> Rudi came from PolyGram, which had a very different culture. The Philips PolyGram culture is highly politically charged; it is much more "stand by your beds when the senior management comes in." Rudi changed a lot when he came to BMG. He saw the value in the Bertelsmann managing style; he saw the freedom to do things, and he took it. He passed it on as well.

Building BMG International One of Gassner's first priorities was to instill this culture in the newly acquired companies. He reflected on what he inherited when he joined BMG:

> My first step was basically to get to know the companies and the problems hands-on myself. RCA had been centrally managed out of New York, and the managers in the companies had the attitude that "I'm not doing anything unless somebody tells me what to do." I would find them hiding under tables. I spent the first two years preaching my gospel and saying to the managers, "You are responsible. I can give you advice, but don't send me a memo asking me to sign off here. You are in charge: you are Mr. Italy; you are Mr. France; you are Mr. Belgium."

At the same time, Gassner also began to communicate his vision for BMG International. "There were basically two strategic targets in my mind," he explained:

> One was globalization. Globalization allows you to serve a bigger world market. Every time we added a new country, we would increase our revenue accordingly. The other strategic target was domestic repertoire. I had a great fear of being too dependent on English-speaking repertoire. I made it clear to the managers that their foremost responsibility was developing domestic talent. Joint ventures and acquisitions were another way to add local repertoire.

Gassner also instituted yearly business plans with each of his managing directors. He described the process:

> We [Gassner and each MD] do a budget once a year. The budget is between you and me. I want to know where you are going and how much investment you will need. We talk about revenues and profits. I make a very aggressive bonus plan for them to be able to make a lot of money; if they exceed their targets significantly, they can make up to half their salary as a bonus. In America, this might not have been so sensational, but for those countries who were not used to that, it was pretty new.

According to Gassner, "the majority of the guys came through with flying colors." For those who did not fit with the new program, Gassner held "career counseling sessions," as one colleague referred to them: "When Rudi conducts a career counseling session, it's pretty much over. But he's so smooth and so good at it, that it takes them about a week to figure out that they may have just been fired."

Gassner also turned his attention inward, focusing on his corporate management structure. "One advantage, obviously, was that nothing existed. I could do it any way I wanted. That was fantastic." He made Joe Gorman, who had been the senior finance executive for RCA's international arm, the chief financial officer of BMG International. During Gassner's first two years, Gorman accompanied him as he travelled around the world assessing each operating company.

Gassner's next corporate hire was Heinz Henn to coordinate global A&R marketing.[9] Henn had spent 17 years at EMI in international positions. He described his job interview with Gassner:

> Rudi and I met for the first time on February 17, 1987, at the Park Lane Hotel and had breakfast together. What got me the job was that I ate two breakfasts—I was really hungry that day. He was impressed that somebody could eat two full breakfasts on a job interview.
>
> Seriously, Rudi asked me what I would do if he gave me the job, and I told him that I would do things differently than they had been done so far in the industry, particularly [the companies] where we had both come from. I wanted to cultivate local talent in individual markets to build hot acts which we could launch globally. He totally agreed with me. Ever since, he's let me do what I wanted to do.

Gassner described the need for Henn's role:

> Heinz has a dual role: he not only has to break local artists worldwide, he also has to sell Whitney Houston to all the local companies. We need Heinz because the interests of the countries and the regions stop at the borders, and we need a global view on artists. This will give us the competitive advantage; there's more money to be made outside the borders if you do it right.

Henn added:

> You have to have coordination between the regions as far as marketing and promotion activities are concerned because recording and marketing expenses are far too great these days for any one [local] company to be able to earn back its investment in one country only. It requires coordination between regions and also globally.

To round out his corporate staff, Gassner added a human resource executive, Ira Sallen, and legal counsel, Jeff Liebenson. Sallen would be responsible for negotiating and maintaining the managing directors' contracts, as well as for worldwide personnel and organizational policies. Liebenson would serve as in-house counsel, assisting in the intricate contracts that were part of operating a complex global enterprise.

Gassner also instituted an annual Managing Directors' Convention in which Dornemann, Gassner, the corporate staff, and all of the MDs and joint-venture partners (JVs) would converge from around the world. A major objective of the annual MD Convention was to provide a forum for the MDs and JVs to give repertoire presentations to each other in an attempt to sell their local repertoire to the other countries.

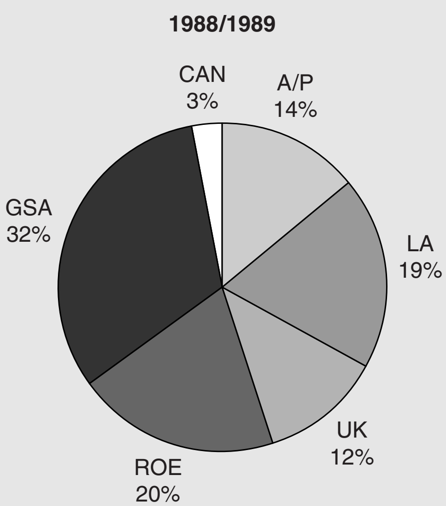
Creating a Regional Structure As BMG International's number of operating companies continued to grow, it became impossible for Gassner directly to oversee them all. By 1989, he concluded it was time to aggregate the countries into five regions and hire a regional director for each, a plan he had had in mind from the beginning. (See **Exhibit 2** for organization chart and **Exhibit 5** for revenue and profit distribution by region.) The role of the RD would be "to provide leadership for the region; to oversee the strategic development of the region, in conjunction with the whole company; and to manage the managing directors." He explained:

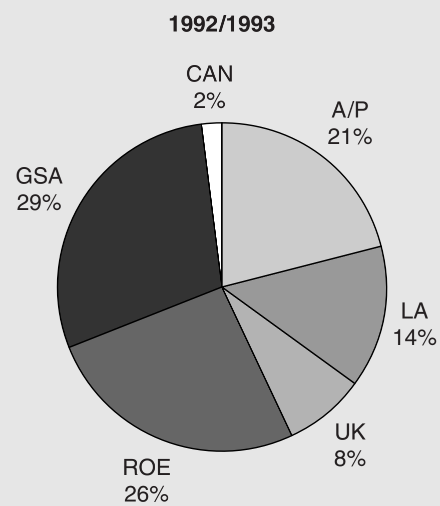
> I divided Europe into three different categories: the United Kingdom, German-speaking territories, and the rest of Europe. At that time, the German-speaking territories contributed about 50% of our profit, so they were a very important group unto themselves. I promoted

[9] "A&R" was a record industry term that stood for "artist and repertoire," record company products. In record companies, investing in A&R to develop talent was analogous to a manufacturing concern investing in R&D. "A&R marketing" was essentially product marketing.

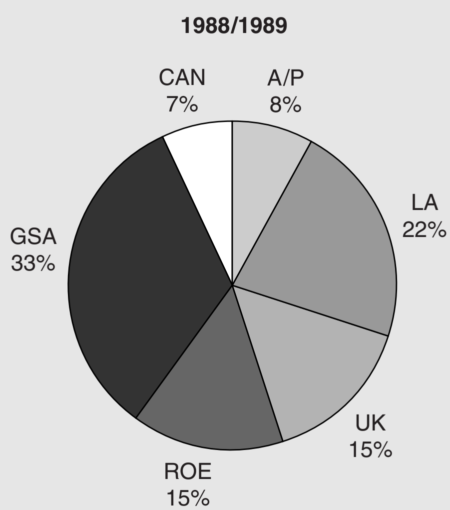
Exhibit 5 BMG International Revenue and Operating Result Distribution by Region

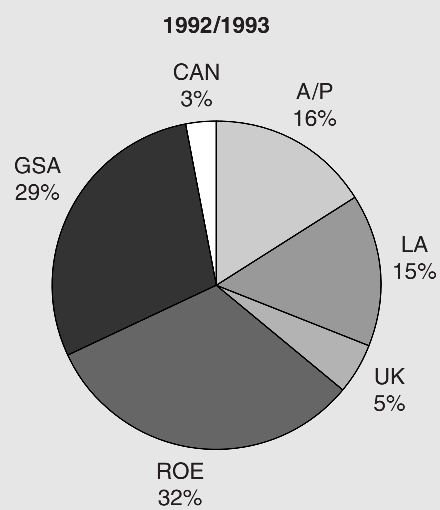
Net Revenue by Region:





Operating Result (Betriebsergebnis) by Region:





Legend:
A/P = Asia/Pacific; Can = Canada; LA = Latin America;
GSA = Germany/ Switzerland/Austria; ROE = Rest of Europe;
UK = United Kingdom.

Thomas Stein, who was the managing director of the German company, to regional director.

The United Kingdom, despite its relatively small profits, was our largest source of repertoire, a major supplier. I promoted John Preston, who was the MD of RCA Records U.K., to be the regional director of that region.

The MD for Ariola Spain, Ramón Segura, was an outstanding executive who also had, at that time, regional responsibilities for Ariola's Latin American companies. So I kept Spain/Latin America together as a region and made Segura the RD.

Now I needed someone for the rest of Europe. I hired Arnold Bahlmann, who was working in strategic analysis for Michael Dornemann. He was not one of the music managers coming through the ranks. He had never had a line job in his life. Still, I thought, you don't necessarily need the detailed day-to-day experience of running a company to manage a regional territory. It was an organizational task, and I thought Arnold had very good people skills. I thought he was ideal, though it was a hell of a risk to put him in.

At the same time as I promoted John Preston to RD in the United Kingdom, I asked the chairman of the RCA U.K. label, Peter Jamieson, to go out and establish our Asia/Pacific market. I remember a British competitor in the industry joking with me that "wasn't I worried about sending one of my best men out to the colonies?" I thought Jamieson was just the right person for the job. He accepted, and he's done a brilliant job building companies and repertoire in that region.

Gassner maintained the annual business planning system he had established with the MDs, but he now worked through the RDs. As Segura described it, "We are involved throughout the process, but Rudi has final approval." BMG International's fiscal year started July 1 and ran through June 30. In January, the MDs began to prepare their business plans, developing targets for critical measures such as revenue, *betriebsergebnis*[10], return on sales, market share, revenue per employee, days inventory, and days sales outstanding. Gassner was as much interested in the assumptions used to arrive at the targets as the figures themselves; MDs were expected to include an in-depth analysis of the risks and opportunities they faced based on the current economic climate and market, new A&R releases, and their priority artists.

In February, the MDs met with the RDs to review their plans; the RDs then met with Gassner to discuss regional as well as local goals. Gorman described Gassner's stance in these meetings: "Rudi has a reputation for being tough—fair, but tough. One of the reasons he has that reputation is that he makes you do things which you know you should do, but which you don't want to do." One RD described these sessions as "the famous February meetings. Rudi and I dislike each other a lot in February. But by March we usually agree."

In March, the RDs returned to the MDs with a final plan and targets; Gassner and Gorman joined many of these sessions (see **Exhibit 6**). At this point, the MDs would have a final opportunity to discuss their plans and the targets would be agreed upon. Gorman described these meetings:

> March is the critical planning month for us. We tell everybody, look, when the meeting is over, we all walk out of here with the same goals. Period. We can sit in the room an hour, or we can sit there for two days, but in the end nobody is going to leave this room disagreeing on what the goals are. In these meetings, MD bonus criteria are also defined, since *betriebsergebnis* is the primary criterion for bonuses.

One RD described Gassner's approach:

> Rudi plays a different role with each MD, depending on their personality and where he wants the country to go. Sometimes he plays the good cop, and other times he plays the bad cop. He's very versatile, and very results-oriented. When necessary, he knows how to hit people's hot buttons and make them squirm.

According to one MD:

> Rudi knows the business inside and out, and he has an amazing grasp of the details. When he is going through these plans, he will go into particular line items if he wants to. These business plans are like contracts between Rudi and me. Face-to-face with

[10]*Betriebsergebnis* was a German accounting term roughly translated to mean profit plus interest costs. The official language at BMG International was English (German was never spoken if a non-speaker was present); *betriebsergebnis* was the only German word the company used.

Exhibit 6 March 1992 Business Planning Meetings Attended by Rudi Gassner and Joe Gorman

Location:	Date:	Review:	
Munich	March 1	10:00 AM	Belgium
		11:30 AM	Netherlands
		2:00 PM	Italy
	March 2	10:00 AM	UK-RCA
		2:00 PM	UK-Arista
		4:00 PM	UK-Distrib.
	March 3	10:00 AM	GSA Overview
		11:30 AM	Munich Ariola
		2:00 PM	Germany Ariola
		3:45 PM	Hamburg Ariola
	March 4	10:00 AM	Germany Ariola
		11:30 AM	Austria
		2:00 PM	Switzerland
	March 5	10:00 AM	France Ariola
		11:30 AM	France Vogue
		1:30 PM	France RCA
		4:00 PM	European Regional Overview
New York	March 10	10:00 AM	Canada
		2:00 PM	Home Office
Hong Kong	March 16	10:00 AM	Australia
		3:00 PM	Hong Kong
	March 17	10:00 AM	Japan
		3:00 PM	Taiwan
	March 18	10:00 AM	South Africa
		3:00 PM	Malaysia
	March 19	10:00 AM	Asia/Pacific Regional Overview
New York	March 24	10:00 AM	Mexico
		2:00 PM	U.S. Latin
		4:00 PM	Portugal
	March 25	10:00 AM	Brazil
		2:00 PM	Spain
	March 26	10:00 AM	Latin America Regional Overview

> him, I am committing to try to make this target. It's like a moral imperative to get it done.

According to Bahlmann, "The business plans serve their purpose well. If you ask me if I enjoy them—no. It's not enjoyable. I hate the process. But it works." Stein concurred: "The business plans help me explain what I think should be done in my region. It's a fair process because it's based on an objective financial measure." Another RD, however, commented on the danger inherent in the system:

> The business plan process is a necessary and effective tool. But the danger is that it becomes too inflexible. Instead of a jacket which guides, a sort of loose piece of clothing which shapes the way we operate, it becomes a straightjacket and restricts the way we operate.

Even with the addition of the regional directors, Gassner maintained close contact with the local companies around the world. "I emphasize what I call a very flat hierarchical structure," he explained. "I'm never too far removed from what's really happening." While he was primarily in contact with the RDs, Gassner always reserved the right to call the MDs directly, and they "feel absolutely free to call me about anything," according to Gassner. "But they all know that it is a two-way information system. Whatever they tell me, they know I will pass on to their regional director. And whatever they tell the RD, they know he passes on to me." When possible, Gassner made it a point to reach further into the organization by talking informally with local employees "just to double-check that my messages come through."

Gassner's style of running a global business was extremely demanding. Travel was a way of life: he and his corporate staff spent 50% or more of their time away from New York headquarters, and the regional directors traveled constantly throughout their regions. According to Gorman,

> Rudi believes that you are not managing an international company unless you travel extensively, because it's all about people. The financial statements are fine, the statistics are fine. But in the end, you have to sit down with somebody in a room and talk to them to get a real sense for the people and for what's going on. There are things that always come out "by the way . . . ." When you go out to dinner or you're at a concert until 4:00 in the morning, a lot of this comes out.

The Executive Committee and the ECMs In 1989, after he had established his corporate staff and the regional structure, Gassner formally created an Executive Committee consisting of the five regional directors, the four senior staff members, and himself as the leader (see **Exhibit 7**). He recalled:

> I had always intended to have an executive committee. I always wanted to run a business on the basis of a European board system, like a *vorstand*:[11] although it is chaired by one person and members have their own portfolios [regions], the committee decides business issues jointly.
>
> The way I see it, the board should decide about important issues strategically or from an investment point of view. And I wanted everybody to be involved in the process, despite the fact that some issues may not have a direct consequence for their region.
>
> You cannot run a global organization without breaking it down into regions—it just becomes impossible. On the other hand, you have to have a global strategy. In our business, the regions are interlinked by artist agreements and by the exchange of repertoire. So it needs both a regional organization and a global vision.

Bahlmann recalled Gassner introducing the concept of an executive committee by describing it as "the group which will lead BMG International." Gassner decided that the committee would meet four times per year at the New York headquarters to discuss current operating issues, and once a year outside of New York to examine long-term strategy. Before each executive committee meeting (ECM), members were polled for agenda items; Gassner then, as he described it, "edited" the suggestions to create the agenda, which was circulated to the group.

Gassner described the first ECM:

> We needed to define the limitations and boundaries of authority among ourselves and the MDs. What should we allow our MDs to do without our approval? What should they have to bring to your level? What should you then bring to my level? We needed certain regulations; it makes our lives easier. It was interesting because of the history of the group coming together—they had not been organized before in a way that had these limitations, and they didn't like it.
>
> I also had to explain the role of the New York staff. There was a lot of theoretical discussion about, for example, Heinz's responsibility. What can Heinz say about my repertoire and my country? How can Heinz say I have to spend a certain amount of money on an artist that is not valid for my region? My answer to that was always that Heinz cannot say. He can only sit down with you and try to convince you that this is the right thing for you. You've got to see the staff as somebody helping you; it is not some governing body who tells you what to do. They have a dotted-line relationship with your people.

[11] A *vorstand* was a German managing board consisting of full-time executive members who carried out the day-to-day operation of the company. It was distinguished from the supervisory board (*aufsichtsrat*), which consisted of shareholders and employee representatives. (Parkyn, Brian, *Democracy, Accountability, and Participation in Industry* (Bradford, West Yorkshire, England: MCB General Management Ltd., 1979), p. 105; and Kennedy, Thomas, *European Labor Relations* (Lexington, MA: Lexington Books, 1980), p. 185.

Exhibit 7 BMG International Executive Committee

From left to right: Arnold Bahlmann, Thomas Stein, John Preston, Rudi Gassner, Heinz Henn, Peter Jamieson, Ramón Segura, Joe Gorman (*not pictured*: Ira Sallen, Jeff Liebenson).

Regional Directors

Arnold Bahlmann
Senior VP, Central Europe

- German, 41 years old.
- Promoted from: Senior VP Operations, BMG.
- 3 years strategic planning, Bertelsmann.
- Doctorate in Political Science.
- Master of Business Administration.

Thomas Stein
President, GSA Territories

- German, 44 years old.
- Promoted from: Managing Director, BMG Ariola, Munich.
- 14 years sales, marketing, and management in record business.

John Preston
Chairman, BMG Records (UK) Ltd.

- Scottish, 43 years old.

New York Corporate Staff

Heinz Henn
Senior VP, A&R/Marketing

- German, 38 years old.
- Promoted from: Director of International Division, Capitol/EMI America Records.
- 17 years A&R/marketing, promotion, and management in record business.

Joe Gorman
Senior VP, Finance and Administration

- American, 50 years old.
- Promoted from: Director, Operations Planning, RCA Records (U.S.).
- 10 years finance at RCA Records.
- 5 years Arthur Young & Company.
- Master of Business Administration.
- Military service, Captain, U.S. Army.

(*continued*)

Exhibit 7 *(concluded)*

Regional Directors	New York Corporate Staff
• Promoted from: Managing Director, RCA Records, U.K. • 19 years retail, marketing, and management in record business. Ramón Segura President, Spain and Sr. VP, Latin America • Spanish, 52 years old. • Promoted from: MD, Spain, and VP Latin American Region, Ariola Eurodisc. • 31 years sales, A&R, marketing, and management in record business. Peter Jamieson Senior VP, Asia/Pacific • English, 48 years old. • Promoted from: Chairman, BMG Records U.K. • 26 years marketing, sales, and management in record business.	Ira Sallen VP, International Human Resources, BMG • American, 39 years old. • Promoted from: VP, Human Resources, Clean Harbors, Inc. • 4 years corporate human resources. • 2 years Consultant, Arthur Young & Company. • 5 years research and clinical psychology. • Master of Business Administration. Jeff Liebenson VP, Int'l. Legal and Business Affairs, BMG • American, 40 years old. • Promoted from: Director, Legal and Business Affairs, SportsChannel America. • 15 years legal experience, including 12 in entertainment industry. • J.D and LL.M. law degrees.

Preston described his perspective on the early meetings:

> At first, there was no role for the RDs. Rudi had things he wanted to do; the agenda was laid out, and we would discuss ways of implementing the agenda. The staff people went into the meetings very well prepared and tried to establish a couple of policies with the help of Rudi in order to structure the business. It took us a certain amount of time to find a way of really working together.

Bahlmann echoed the same point:

> Rudi needed to establish himself and the regional structure; it was like him telling us, via the agenda, what we're going to do. It was our "educational process." Although I think we sometimes found it frustrating, we were so busy with our own companies [regions], there was not a lot of resistance.

Gassner found this lack of "resistance" somewhat disconcerting. According to Gorman,

> I remember after the first two ECMs, Rudi saying to me, "Everybody's too nice." He expects strong dissenting opinions. He doesn't want a bunch of people just sitting there mildly accepting anything. To him, a heated argument over an opinion is part of the fun of the job, I suppose. But if you're not used to this, and when I first started with him I wasn't, it jars you a little.

In time, however, the RDs became more vocal. According to Henn, "It took quite some time until the group felt comfortable enough with each other that they dared to say what they really wanted to say." According to the RDs, the shift in the ECMs was due to their growing confidence and success in running their regions. As Bahlmann noted:

> About two years ago it turned around. The regional directors and the managing directors make the decisions about the operating businesses and acquisitions. Today in the ECMs, we go more into other issues. More and more, we are finally making decisions together and running the business as a team.

Preston also commented on this shift in emphasis: "In the beginning, the staff and Rudi were more dominant. But now, it's more balanced between Rudi and the RDs, and then the staff."

Working Together By 1993, the executive committee and the ECMs had been in place for four years, and the meetings had fallen into a fairly regular pattern. Each agenda would include a presentation by Gorman on current financial results relative to targets; a discussion by Henn about A&R developments, new releases, and priority artists; a briefing by Sallen on significant worldwide human resource issues; and an update on each region by the RDs. Gassner described the importance of these regional reviews: "I want to give them room to explain to their colleagues what they're up to. Even though it's not relevant to somebody running South America, for example, he should listen, in my opinion, to what happened in Korea and how we do business in Korea. Here is where I try to get them involved in the global strategy."

Outside the ECMs there was frequent contact between Gassner and each RD. Contact among the RDs varied, and was most frequent among three of the European directors: Bahlmann, Stein, and Preston. Because they shared so many of the same circumstances and concerns, Gassner established a European subcommittee in 1991. As he explained,

> I created a European board because I didn't want to be in the middle of those discussions all the time. It seemed natural to make Arnold the chairman, since he is also the head of European-wide manufacturing and distribution. I told them: "You guys deal with European issues. Europe is your baby. If you cannot agree, I get the minutes and then I will make a ruling."

Since its inception, the European board had been very effective in achieving the purpose he had intended, according to Gassner:

> They deal with issues that are really not relevant to anybody else before they get to the ECM. They even discuss the ECM agenda before the meetings, and they sometimes come over with what I call a "prefabricated opinion." So now sometimes I have to work to break this group up a little bit.

Depending on their regional circumstances, the roles of the RDs varied significantly. Bahlmann, Preston, and Stein, for example, focused on continuing to carve out market share and bring costs down in their increasingly mature markets. Because of his region's importance as a repertoire supplier, Preston was seen as the "repertoire expert"; Bahlmann, on the other hand, was the "strategy expert." Segura and Jamieson were most concerned with establishing new companies and developing talent in the relatively undeveloped markets of Asia and Latin America. Jamieson commented on the satisfaction of being a "pioneer," as he called it: "Asia/Pacific is a huge, multicultural, diverse, economically varied region which is on exactly the opposite side of the world from America. It has the most growth potential and the most musical excitement, really. It's a very, very exciting place to be." Segura described the unique challenges in his region: "I am constantly battling against the terrible political and economic instability that affects some of the countries in my region. These situations cannot be solved with easy solutions or off-the-shelf business recipes."

Over time, the executive committee members developed a strong sense of mutual respect for one another. According to Henn:

> Everybody in that room is the *best* at what he does. The absolute best, and we all know it. It's pretty amazing. We're also total egomaniacs, the whole group of us. But in this company we still work as a team because we give each other the space to be the fool that everyone can be sometimes. Nobody's perfect.

Another RD commented, "I wouldn't necessarily choose these guys as my friends, but when we get together it's pretty awesome."

The group maintained a balanced mix of camaraderie and competition. Gassner, who himself used to play professional soccer, described the committee as "more like a soccer team than [an American] football team"; they frequently played heated games of golf or soccer when they were together. Stein remarked with a laugh, "It's all healthy competition—it's very healthy as long as I'm on top of the others. But seriously, it's a good sort of competitiveness. We are all ambitious people, but we respect each other; there is no jealousy."

Another executive committee member mentioned a different aspect of competition: "Rudi is only

51 [years old], far from the required retirement age of 60; but chances are good that he could move on to other things at Bertelsmann. As a result, there is a certain amount of jockeying for position within the executive committee, and people wonder if a non-German could ever be tapped to run this company."

As for Gassner's role in the ECMs, committee members had varying perspectives. Stein commented that "Rudi has a good relationship with the team. He knows when to be part of the team, and when to say yes or no. But he's always open-minded, and you can discuss things with him; it's like a partnership with him." According to Sallen, "Rudi does a lot of consensus-taking. He floats ideas by people, testing them on the group. He does impose his will, but not often. While he does not hand down many edicts, it is generally clear to all what his feelings are on most issues."

Jamieson, however, observed: "Debates in the ECMs are very rare. Rudi's not a man who needs or wants too many debates. I have never had an informal brainstorming session with him, a relaxed, almost agenda-less discussion. Rudi's management style is essentially autocratic." Henn commented:

> Rudi's brilliant. He's a tyrant; no, not a tyrant, a dictator. He has to be. You don't have a leader if you don't have a dictator. If you don't have a dictator, you won't be successful. Show me a company run by democracy, and I'll show you a loser. There's always got to be one chief and plenty of Indians.
>
> He's very smooth. If he thinks we're coming to a conclusion that is not what his opinion is, he will make sure the whole thing will turn his way. He has the ability to make you feel it was your idea, and if that doesn't work, he'll tell you to go and do it anyway.

Many committee members agreed that it could be difficult to change Gassner's mind. According to Stein, "To influence Rudi, you have to convince him. You have to be prepared properly with logical arguments." Preston added: "You have to be prepared to stand up for your argument. A lot of what he is testing is how much you really believe in what you are saying."

One RD noted that "Rudi usually does not allow himself in any way to be influenced by people who are not speaking directly about the areas for which they are responsible. In other words, he'll be very receptive to me for everything within my area, but when I stray into areas of the general good, I find him very unreceptive. I also find that I can influence him more one-on-one than I can in the ECMs."

Stein commented that he used the ECMs "as a tool to influence things in a way that I think they should go and to make the other RDs aware of things. Whether or not the committee agrees with me is another question." Preston agreed, explaining that he viewed participation in the ECMs as an important responsibility, even if it was sometimes hard to have much influence: "I believe that I have a job in the context of the group to say the things that I believe in order to get the group to behave in ways that I think are the right ones."

Bahlmann described the ECM as "an opinion-building exercise," explaining that:

> Real decisions about who gets money for what acquisitions occur outside of the meetings. The other thing is that there has always been money there to do what we wanted. So for me, the group has never been tested to see whether we can really work as a team under pressure when it comes to a fight over who will get funds for what investment.

Jamieson commented:

> Sometimes I feel that the main benefit of my coming all the way from Hong Kong to New York for the ECM is the ability (a) to meet my colleagues and chat with them from time to time, and (b) to have my separate meeting with Rudi, which is my best opportunity to influence him.
>
> We have had some good meetings, and we have had some terrible meetings. Rudi occasionally runs them in an open way in which debate is invited and variations to policy are considered. In reality, there is not a team "working together" at the top; there are executives implementing predetermined policies in different areas. The enormous geography makes it difficult to manage by consensus. With Rudi, you know what you have to do, and you have the freedom to execute the policies in your own region with your own style. Nevertheless, you have to realize that Rudi's style works for him; the proof is his incredible success over the past six years.

Gassner suspected these feelings and opinions in the group. "Many of them probably think I am influencing them more than I should," he commented.

> Sometimes I hear grumblings and they say that they can't always express their long-term ideas at the meetings because the meetings are so focused. I think they feel a lot of things are a bit too prepared or precooked. It's true—they have a difficult time convincing me. I am a person who likes to win an argument.
>
> But my opinions are not just invented on the spot. I usually discuss issues one-to-one with certain people beforehand. If I have a subject on the agenda, I almost always have an opinion of what I think the outcome should be. And then in the ECM, I see if my belief is confirmed. Occasionally, I may not go ahead with my original idea because I see that the entire group is going in another direction. In that case, I will take a step back and try to analyze it one more time, and I may change my mind. But if I see that they agree, or if it's just very important to me, then I obviously try to push it along.

Reflecting on his original hopes for the role of the executive committee, Gassner commented:

> It turned out to be a little bit different than I thought. I thought there would be more interface on strategic issues. I had hoped that they would contribute to problems which went beyond their ultimate responsibility.
>
> In part, I guess it's because it's such a diverse group of people. Segura, for example, is an outstanding executive, but because he thinks his English is limited, he would rather discuss issues separately with me than in an open meeting. Bahlmann, on the other hand, is very interested in global strategy though sometimes he doesn't have as much impact as he would like to have. Stein and Jamieson are somewhere in the middle, and they are driven primarily by the success of their own regions. Preston is highly intellectual; he is also the biggest repertoire supplier, and sometimes he thinks we're not paying enough attention to his repertoire. It's a combination of very diverse people. That's probably why the results are still so much influenced by me.
>
> And it may very well have to do with me and the way I run things. I think I know what is good for us. Therefore, when I'm convinced that that's the right way to go, it takes a great effort to get me off that route. However, because it has been successful, it has been hard to say that I should change my style.

The May 1993 ECM

Gassner opened the 1993 Managing Director's Convention in Boca Raton with a speech in which he stressed that the company's key success factor for the future was creating repertoire. "It's local artist development, it's joint ventures, it's acquisitions. That is the way we are going to grow. That is how we will reach our goal of becoming Number 1," he told the audience. He also congratulated them on another year of success in surpassing their business targets, but joked that "I am so naive; you must be lowballing your plans every time, because you have never missed them."

The week-long convention also included a session by Henn on developing A&R; a financial presentation from Gorman in which he emphasized the need to reduce costs and improve efficiency as markets matured and growth in the record business leveled off; a presentation about new recording and media technologies; and a speech by Dornemann about the future of the emerging Entertainment Group at BMG.[12] While the RDs attended, they played no formal role in the convention.

Whereas the focus in past conventions had been primarily on growth, the topics which formed the agenda for the 1993 MD Convention—global artist development, new technologies, BMG's expansion into new entertainment arenas, and cost control—emphasized disciplined management to position BMG International for the next phase. The MDs were excited about the important new role that BMG International could take on in the future. As Gassner told them, "We're the only company in Bertelsmann that is really global; we're the only ones in Japan, and we have over 300 people there.

[12] In response to trends toward multimedia entertainment technology, Dornemann had begun to look toward expanding BMG's reach in the entertainment industry to include television and even film. Industry analysts speculated that Dornemann was interested in purchasing an independent film studio, but such a deal had not yet materialized. In September 1993, BMG announced a joint venture with Tele-Communications, Inc., the largest cable system operator in the U.S., to launch a hybrid music video/home shopping cable channel that would rival MTV and VH-1. (Robichaux, Mark and Johnnie L. Roberts, "TCI, Bertelsmann Join to Launch Music, Shopping Cable Channel," *The Wall Street Journal*, September 17, 1993.)

If Bertelsmann wants to sell film or video games globally, we are there. We have something Bertelsmann can build on."

On the other hand, many of the MDs expressed skepticism about Gassner's "conflicting messages." As one stated, "You can't grow market share unless you're willing to spend money, and you can't cut back on investing in new acts, because you never know who might be the next Rolling Stones." Gassner, however, did not see his goals in conflict: "Yes—it's inconvenient on the one hand to grow and on the other hand to control your costs. It's a difficult task, but I expect both. I cannot allow anyone to just charge ahead regardless of cost. I expect a balance; and I know they can do it."

These issues also figured heavily into Gassner's agenda at the May ECM, which took place during the convention. He knew that the future challenges would demand more cooperation and global strategic thinking on the part of the executive committee. They had all been extremely successful so far in their own regions, but a regional focus alone would no longer be enough to guide BMG International through the uncertain and ever-changing terrain of the next five years.

The Reduced Manufacturing Price The reduced manufacturing price was a result of negotiations undertaken by Bahlmann with Sonopress, Bertelsmann's central manufacturing operation in Europe, which supplied product to the European countries. These countries were required to purchase a certain percentage of their CDs, records, and cassettes from Sonopress, and as part of his responsibilities as the head of central manufacturing, Bahlmann negotiated the transfer prices annually by comparing Sonopress's bid to those of outside vendors. Because the non-European countries did not source through Sonopress, they would not be affected by the new price.

As Gassner might have predicted, when he brought up the issue at the ECM by congratulating Bahlmann, Preston shot Stein a knowing glance. Preston was required to source his manufacturing through Sonopress even though he could get a better price by using a U.K. vendor. As he explained:

> Because the United Kingdom is such a large repertoire supplier, I have volume benefits which I offer Arnold. He takes my volume, combines it with the other European countries, and negotiates a manufacturing rate with Sonopress in Munich, and then I buy the product back with the exchange rate working against me. Austria pays the same price as I do, getting the benefit of my volume scale.

Gassner then raised the question of what to do in response to the new prices. There was a long pause at the table. Bahlmann responded first by suggesting that the "extra" profit from the regions be placed in investment funds for each territory. Stein argued that this was not necessary "since the money's always there if the investment is good anyway." The group agreed that the money did not need to be placed in a separate fund, but be left to each company to decide how to use.

"OK, so what about the targets?" Gassner asked. Looking down at his copy of the calculations that Gorman had distributed before the meeting, he continued, "There are significant variances here. An MD's *betriebsergebnis* in some cases could be increased by as much as 50% due solely to the price reduction."

Segura then spoke up: "This doesn't affect me in my region, so I can be objective.[13] We have never before changed targets once they have been set. Not for any reason. So I don't see why we should change them this time." Preston added: "I agree. Some years, I'm hurt by the transfer pricing and exchange rate, but our targets have never been eased to reflect this. So why would we change them now that it's working the other way? It doesn't seem fair."

Indeed, many of the executive committee members found the issue an unusual one for the ECM agenda. As Gorman explained,

> To tell you the truth, I was a little surprised when Rudi asked me to calculate adjusted business targets to reflect the new manufacturing price. I know I'm the one who has been pushing reexamination of our cost

[13]Since the Latin American region included Spain and Portugal, Segura was affected minimally by the reduced price.

structure. But we've never changed the targets. Whether you acquired a company, lost a company, lost a customer, had a major bankruptcy, an artist didn't release—we've had everything you can imagine happen, and I do not remember ever adjusting the targets for anybody, for any reason.

Gassner said, however, that he was concerned that some of the MDs might become "complacent" because their *betriebsergebnis* target would be substantially easier to meet if it were not adjusted. "I want to maintain the challenge of an aggressive bonus target, I want the MDs to be held accountable for the savings. I want them to realize that it isn't just a Christmas gift," he explained to the group.

No one at the table responded or looked in Gassner's direction. Gassner then wondered how he could get them to address the question of changing the targets, a possibility they seemed unwilling even to consider.

Case 4-3 Bombardier Transportation and the Adtranz Acquisition

On January 10, 2001, it had been one month only since Pierre Lortie was appointed president and chief operating officer of St. Bruno, Quebec-based Bombardier Transportation (BT).[1] BT was one of three major operating groups of Montreal, Canada-based Bombardier Inc. (BBD) and, with 2000 revenues amounting to Cdn$3.45 billion, it was one of the world's largest manufacturers of passenger rail cars. In an effort to expand BT's presence in the global rail equipment industry, executives at BBD had recently completed a successful negotiation for the acquisition of Adtranz from DaimlerChrysler for US$725 million. At approximately twice the size of BT, Adtranz (headquartered in Berlin, Germany) would not only expand BT's revenues and geographic scope but would significantly increase its competencies in propulsion systems and train controls and would complete its product portfolio. However, before the deal could close, BT required, among others, the regulatory approval of the European Commission (EC). Lortie was well aware that the EC process could be long and protracted.

Although Lortie had not been directly involved in the acquisition decision or negotiations, he was a supporter of the merger efforts. As he assumed his new responsibilities, Lortie began a thorough review of the work accomplished and the planning efforts undertaken to ensure an efficient integration of the two entities. As part of this process, he undertook a series of one-to-one meetings with members of his senior management team. The meetings were designed to measure the strengths and weaknesses of his key managers, but also to discuss the strategic and operational priorities.

BT was structured into five geographically-based operating units—North America, Atlantic Europe,

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David Barrett prepared this case under the supervision of Professor Allen Morrison solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

[1]St. Bruno was located on the south shore of the St. Lawrence River, in the suburbs of Montreal.

Continental Europe, Mexico and China—and one market/functional unit, Total Transit Systems—which focused on turnkey projects. In contrast, Adtranz was organized around product segments (i.e. high speed trains, cars, subway trams) and functions (i.e. bogies, drives, car bodies) making its structure and allocation of responsibilities quite foreign to Bombardier. Although each business complemented the other nicely and constituted a good strategic fit, the organizational structures were incompatible. Even though, BT's management team in Europe had not been involved in the discussions and reviews with Adtranz that had preceded and immediately followed the deal, they were keenly aware of the organizational issues and eager to establish their position as soon as the nod could be given to proceed with the takeover.

On January 10, 2001, Lortie had just finished his first in-depth meeting with Rick Dobbelaere, vice-president of operations of Bombardier Transportation, Atlantic Europe. Dobbelaere had come prepared with questions about how BT and the senior management team would set priorities during the interim period while awaiting EC approval. He presented these to Lortie in question form:

> Do we sit and await approval from the EC before taking steps towards the potential integration of Adtranz? Should we focus our planning on ways to improve the product quality and reliability of Adtranz equipment with existing customers? Should we start to institute personnel changes within BT in anticipation of the merger, and if so, at what pace? Do we focus on top-line revenue growth or start to immediately focus on bottom-line cost cutting?

Dobbelaere was highly respected, not only within the Atlantic Europe division but throughout Bombardier, and Lortie was aware that his concerns and questions were shared by others, particularly in Continental Europe.[2] But Lortie realized that he faced additional issues, including concerns over BT's ongoing operating performance. As Bombardier expected EC approval of the acquisition within a matter of weeks, Lortie and his team had little time to waste.

Bombardier Company History

The Early Years In 1921, at the age of 19, Joseph-Armand Bombardier opened a garage in Valcourt, Quebec, where he earned his living as a mechanic. Early in his life he looked for a solution to the problem of traveling the snow-covered roads near his village, which kept many people isolated during the long winter months. Over a 10-year period, Bombardier used his garage to develop multiple prototypes of a vehicle that would make winter travel easier. In 1936, he submitted his B7 prototype, the precursor to today's snowmobile, for patent approval. This seven-seat passenger model sported a revolutionary rear-wheel drive and suspension system, both major innovations at that time.

After receiving an initial 20 orders, Bombardier assembled a work crew of friends and family to manufacture the B7s. Customers included country doctors, veterinarians, telephone companies and foresters. By 1940, Bombardier had built a modern factory in his village that had an annual capacity of 200 units. In 1942, Bombardier incorporated his business as L'Auto-Neige Bombardier Limitee (ANB). Shortly thereafter the company began to receive orders from the Canadian government for specialized all-track vehicles for use by the armed forces efforts during the Second World War. Between 1942 and 1946, ANB produced over 1,900 tracked vehicles for the Canadian armed forces. Although not a profitable venture, the war-time manufacturing experience allowed Bombardier to refine his manufacturing process and develop competence in government relations.

The 1950s saw technological advances in lighter engines, improved tracking and high-performance synthetic rubber. In 1959, Bombardier achieved his lifelong dream when ANB introduced a one-passenger snowmobile. At an original price of Cdn$900, the Ski-Doo sported five-foot wooden skis, a coil spring suspension system and could travel at speeds of up to 25 miles per hour (mph). Sales increased from 225 units in 1959 to 2,500 units

[2] BT Continental Europe was based in Berlin and included six manufacturing facilities in Germany and one each in Austria and the Czech Republic.

in 1962 and 8,000 units in 1964. Joseph-Armand Bombardier died in 1964, leaving a Cdn$10 million company to his son, Germain.

In 1966, Germain Bombardier passed on the presidency to his 27-year-old brother-in-law, Laurent Beaudoin, and in 1967, the company name was changed to Bombardier Limited. In 1969, the company went public with the intention of utilizing the funds to vertically integrate and increase its manufacturing capability. BBD grew as the market for snowmobiles rapidly expanded in the late 1960s and early 1970s. The North American snowmobile market grew from 60,000 units to 495,000 units in the period between 1966 and 1972, and BBD captured one-third of this market. Between 1966 and 1972, BBD's sales soared from Cdn$20 million to Cdn$180 million while profits rose from Cdn$2 million to Cdn$12 million. Under Beaudoin's leadership, the company pushed into the lucrative U.S. market, unveiled new products and utilized aggressive marketing initiatives to drive the business. In 1970, the company completed the acquisition of Austrian-based Lohnerwerke GmbH. Lohnerwerke's subsidiary, Rotax, was a key supplier of engines for Bombardier Ski-Doo snowmobiles and also a tramway manufacturer. This provided BBD with its first entry, albeit involuntarily, into the rail business. The energy crisis of the mid-1970s put the brakes on the snowmobile industry, and when the dust settled, the largest of the six remaining manufacturers was BBD.

Bombardier Begins to Diversify Laurent Beaudoin, the chief executive of Bombardier, realized that in order to reduce cyclical risks and ensure its long-term survival, the company needed to diversify into other products beyond snowmobiles. To bolster sagging snowmobile sales, Beaudoin began to seek out opportunities for BBD within a more broadly defined transportation industry. In the late 1960s and early 1970s, BBD made several strategic acquisitions.

Transportation In 1974, snowmobiles represented 90 per cent of BBD revenues. By securing a Cdn$118 million contract (US$99.14 million) with the city of Montreal to supply the local transit authority with 423 subway cars, BBD had made its first major move to diversify its revenues away from its predominant snowmobile business. Using rubber-wheeled cars licensed from the supplier to the Paris subway system, BBD's work won positive reviews from Montreal commuters. Further contracts followed, including supplying 36 self-propelled commuter rail cars to Chicago in 1977, 21 locomotives and 50 rail cars to Via Rail Canada in 1978, 117 commuter cars to New Jersey Transit Corporation in 1980, 180 subway cars to Mexico City in 1982, and 825 subway cars to the City of New York, also in 1982.

The mid-1980s was a turbulent time in the rail transportation industry, and BT looked to capitalize on industry uncertainty by purchasing companies at low prices and growing its market share through these acquisitions. Pullman Technology was acquired in 1987, Transit America in 1988, and controlling interests in rail equipment companies in France and Belgium in 1988. In the early 1990s, BT also acquired Concarril (Mexico's top rail manufacturer) as well as UTDC in Canada. These acquisitions and investments established BT as one of the leading supplier of rail cars and cemented its international reputation.

Aerospace In 1973, BBD commenced diversification into the aerospace business with the acquisition of a controlling interest in Heroux Limited of Longueuil, Quebec. Heroux designed, manufactured and repaired aeronautical and industrial components at its two Canadian plants. In 1986, following an international bidding contest, BBD acquired struggling Canadair from the Canadian government at a total cash and share price of Cdn$293 million. By applying aggressive marketing tactics, cost-cutting measures and tight controls, BBD was quickly able to turn operations around. Subsequent acquisitions of Short Brother PLC (an aircraft producer in Northern Ireland) in 1990, Learjet Corporation in 1990 and a controlling stake in de Havilland in 1992 and the remaining interest in 1997 firmly entrenched BBD in the civil aircraft industry. During the 1990s, BBD introduced a series of new planes including the Lear 60, the Challenger 600-3A, the Challenger 604 and the Lear 45. BBD delivered its first Canadair Regional Jet in 1992 and its first Global Express business jet in 1999, the CRJ 700 (75 seat jet) in 2001.

Corporate Balance By the early 1990s, BBD had diversified to the point where snowmobile sales represented less than 15 per cent of the company's revenues. BBD still controlled 50 per cent of the Canadian market and 25 per cent of the U.S. market for snowmobiles, but BBD had clearly established itself as a diversified company. By 1992, sales had increased to US$3.43 billion and profits to US$104 million. While, in many cases, the companies acquired by Bombardier were in poor shape, observers noted that the majority of Beaudoin's deals and acquisitions had been turned around and were making money.

Different operating groups at BBD took centre stage at different times during the 1990s (see Exhibit 1). In 1994, the recreational products group seemed to surge forward, fuelled by increased snowmobile sales and sales of Sea-Doo watercraft, first introduced in 1968. Profits from this group represented 37 per cent of the company's profits and made the recreational products group central to the company's success. The mid-1990s saw a boom in the aerospace group as both regional and business jet sales took off with the expanding economy. Many observers credited Bombardier with creating an entirely new commuter jet segment as the result of product innovation. Aerospace group sales grew from 1996 levels of US$3.16 billion to 2000 levels of US$7.79 billion. In 2000, the aerospace group represented 66 per cent of the company's revenues and 85 per cent of its profits.

BT continued to grow during this period as well. BT was awarded a prestigious contract to produce specialized rail cars for the huge Eurotunnel engineering project. In early 1995, Waggonfabrik Talbot KG of Germany was acquired for $130 million cash. In late 1997, BT acquired DWA Deutsche Waggonbau GmbH of Berlin for Cdn$518 million (approximately US$359.52 million) and thus doubled its train and subway car manufacturing capacity in Europe. In December of that year, BT secured a US$1.18 billion contract with Virgin Rail Group of Great Britain to supply 78 diesel/electric multiple units and rail cars. In November 1999, the company entered into a joint venture to construct a manufacturing facility in China and to subsequently build 300 inter-city mass transit railcars for the Chinese Ministry of Railways (see Exhibit 2).

Bombardier Growth Philosophy BBD sought acquisition opportunities that allowed it to add value to the business through the application of its existing competencies. Acquisitions were typically not viewed solely as financial plays but as a way for BBD to complement or strengthen its existing businesses. BBD prided itself on thoroughly evaluating target companies so that pay-back was not reliant on the divestiture of some aspect of the acquired business. In negotiations, BBD had also shown that it was not afraid to walk away from a deal if it meant overpaying for a business. But once a deal was completed, BBD had a reputation for being patient in the integration of the acquired company.

In addition to a strong track record of integrating acquisitions, BBD had strengths in product costing and tendering. It also had extensive experience in product assembly. Whether aircraft, recreational products or rail cars, most products made by BBD were assembled as opposed to manufactured. Utilizing external suppliers and adopting just-in-time delivery methods resulted in substantially reduced inventory levels, throughput time and assets. BBD sought ways to control product technology and design, assembly and distribution while outsourcing other non-core functions.

When taking over a business, BBD tried to eliminate waste and turn around underperforming assets by applying tried and tested management approaches over time as opposed to rushing to replace existing methods. This approach to acquisitions had garnered strong employee support over the years as

Exhibit 1 Bombardier Revenue and Profit History, 1992–2001 (Cdn$ million)

Fiscal Year*	Overall	Transportation	Aerospace	Recreational Products	Capital	Other
2001e	16,101	3,043	10,562	1,687	1,033	(224)
2000	13,619	3,446	8,126	1,473	739	(165)
1999	11,500	2,966	6,444	1,628	571	(109)
1998	8,509	1,679	4,621	1,633	245	332
1997	7,976	1,597	4,011	1,866	162	341
1996	7,123	1,575	3,309	1,641	140	459
1995	5,943	1,310	2,981	1,111	112	430
1994	4,769	1,312	2,243	791	97	323
1993	4,448	1,238	2,228	556	58	367
1992	3,059	726	1,519	391	56	366

Profits Before Taxes, Segmented by Division

Fiscal Year*	Overall	Transportation	Aerospace	Recreational Products	Capital	Other
2001e	1,428	121	1,237	86	(15)	—
2000	1,124	174	904	18	28	—
1999	827	148	682	(46)	43	—
1998	627	85	462	1	64	16
1997	606	63	270	212	47	14
1996	461	100	150	174	42	(6)
1995	346	66	141	117	22	(1)
1994	207	(24)	137	76	14	4
1993	151	(73)	181	29	7	7
1992	121	4	137	(9)	(12)	2

Revenue, Segmented by Region

Fiscal Year*	Overall	Canada	Europe	United States	Asia	Other
2001e	16,101	1,241	4,757	8,592	471	1,040
2000	13,619	1,013	4,362	7,139	327	779
1999	11,500	900	4,049	5,497	259	796
1998	8,509	962	2,260	3,964	760	563
1997	7,976	949	2,342	3,712	605	367
1996	7,123	4,504	1,779	841	—	—
1995	5,943	3,619	1,536	789	—	—
1994	4,769	2,696	1,431	642	—	—
1993	4,448	2,335	1,675	438	—	—
1992	3,059	1,331	1,373	355	—	—

e - estimate
* fiscal year end January 31. As a result, 2001 data essentially covers results from 2000.
Source: Company files.

Exhibit 2 Overview of Bombardier Businesses in 2000

Bombardier Inc.

Businesses	Leadership Position
Recreational Products Group Snowmobiles (Ski-Doo) Personal watercraft (Sea-Doo) Small engines (Rotax) All-Terrain vehicles Neighborhood electric vehicles Sport boats	No. 2 globally No. 1 globally No. 1 in ultra light aircraft engines Launching No. 1 globally
Transportation Group Mass transit and systems	No. 1 in North America, No. 4 in Europe
Aerospace Group Business jets (Challenger, Global Express, Learjet 31A, 45, 60) Commercial aircraft (Canadair Regional Jet, Dash 8) Amphibious aircraft (CL415)	No. 2 globally No. 1 in 29–50 seat globally No. 1 globally
Capital Group Dealer inventory financing Commercial industrial financing Railcar leases Manufactured housing mortgages Targeted consumer financing	Strong positions in niche markets

Source: Adapted from *McKinsey Quarterly,* 1997, Volume 2.

workers realized that BBD would invest in new products and thus protect jobs. When BBD entered the aerospace industry through acquisitions, it did not replace existing staff. Instead, it used personnel from BT to teach successful approaches and manufacturing methods developed elsewhere in the organization. Transfers were not all one way; aerospace also shared its best practices in engineering management. With a commitment to excellence in assembly, inventory and management control, the aerospace group and BT were both able to make significant gains in productivity and product quality.

Despite the similarities in operating strategy, BBD's businesses differed in important ways. Bombardier's rail business was counter-cyclical versus other businesses in the company. An event, such as an energy crisis, would affect the rail industry differently than recreation or aerospace. Also, technology and product development were somewhat different across the businesses. In recreational and aerospace products, a Ski-Doo or business jet was developed for the market in general while in rail, each customer had unique requirements and demanded tailor-made products. Generic rail cars simply did not exist. Customer demand varied according to a wide range of factors, including car size, weight, number of doors, propulsion system and so on. Other variables included the materials being used (steel versus aluminum), the type of car being produced (tramway, subway, inter city or high-speed rail) and the infrastructure interface (track width).

BT was well regarded for its competencies in assembling rail cars, but it had no in-house expertise in propulsion systems, locomotives and switching and communications gear. Mark Cooper, vice-president of supply management of the inter-city trains for Adtranz, commented on Bombardier's reputation:

> Overall, Bombardier had a good level of credibility in the market place, despite being the smallest of the four rail manufacturers and rail service providers. It was seen to be one of the most effective in terms of its ability to deliver contracts and to manage and govern itself.

The Global Rail Transportation Industry

In 2001, the railway transportation industry could be divided into six distinct segments: services, propulsion and controls, total transit systems, rail control solutions, rolling stock and fixed installations. Bombardier was absent from the last segment which it considered as non-strategic and quite distinct in nature from the others.

1. Services included the planning and implementation of high quality production and maintenance programs for both new and existing systems. Services also included the development of long-term process improvements to both systems operation and rolling stock maintenance.

2. Propulsion and Controls provided the diesel and electric motors, traction drives and control systems for trains.

3. Total Transit Systems provided a process through which manufacturers developed and supplied complete transportation systems and services. Working in partnership with local civil contractors and suppliers, manufacturers designed, integrated, installed and delivered a broad range of technologies—from large-scale urban transit systems to airport people-movers.

4. Rail Control Solutions were required to operate safe and efficient railways. Customers needed effective and "fail-safe" rail control and signaling equipment and systems.

5. Rolling Stock included subway cars, locomotives, inter-city/regional trains, high speed trains, tram cars and light rail.

6. Fixed Installations referred to the building of rail infrastructure.

Public Policy and the Role of Governments in Regulating the Industry The role of transportation and, with it, the attitudes and values of the public and government differed considerably from country to country and from continent to continent. Differences in public policy affected travel behaviors in a major way. While the cost of raw fuel amongst developed nations varied only marginally, fuel taxation levels differed by up to 800 per cent. As a result, public policy decisions affected not only the demand for fuel but also the demand for public transportation as an alternative to the automobile. Because of lower gasoline taxes and the promotion of automobile travel in the United States, public transport ridership was three to nine times lower there than in European countries.

Most industry analysts believed that European policies promoting reductions in congestion, pollution abatement, urban development, traffic safety and energy conservation would continue and that support for public transportation systems would continue for the foreseeable future. The question was whether the United States would embrace European norms as congestion increased in that country. The combination of greater geographic distances, car-friendly culture, efficient and large air travel system and aversion to government subsidies convinced many that U.S. rail policy would take a great many years to significantly change in a direction that supported an increase in rail transportation usage and investment.

Government regulations significantly affected industry structure in one other important way. Because U.S. passenger trains frequently shared tracks with freight trains, the government mandated that U.S. passenger rail cars be reinforced and strengthened in order to sustain collisions without collapsing with the ensuring high casualties that would result. As a result, U.S. trains were substantially heavier than European trains and were uncompetitive and poorly adapted to markets outside North America. European Union standards were widely embraced by governments and customers throughout the world, particularly in emerging economies such as China and India.

Infrastructure Model A common perception in both Europe and the United States was that the rail industry, as a whole, was best designed to operate as a monopoly. High sunk costs, low marginal costs and demands for managerial co-ordination perpetuated this opinion. However, the emerging approach in the European Union (EU) was to separate the high-speed train industry and subject its component parts to competition. Although the potential technical, economic and social gains associated with this approach were perceived as exceptional, the process was often complicated by different national visions of how the industry should be divided between public and private ownership. Most countries opted to retain state ownership of infrastructure with the creation of a state agency to manage it. However, rolling stock companies were slowly becoming privatized. In 1998, the United Kingdom became the first country in the EU to totally privatize its rail system, including both infrastructure and rolling stock (see Exhibit 3).

The U.K. model of privately owned infrastructure and rolling stock had its troubles. The government was forced to operate the infrastructure element of the system when Railtrack, the private company it selected to manage the vast U.K. rail infrastructure (nearly 23,000 miles of track and 2,500 stations), went bankrupt in October 2001. Also, some in the United Kingdom worried about safety risks associated with spreading accountability across multiple for-profit companies. Conversely, the French model of public-owned, train operator had been a tremendous success. As one industry observer remarked,

> France was operating state-of-the-art 300 km/h trains on a new network of rail lines dedicated to fast passenger service, and making money doing it. Britain was operating 1960s technology, 200 km/h trains on the nation's undependable and failing 19th century freight/passenger network, and losing money.[3]

Despite the success of the publicly operated French system, the EU was not designed to promote monopolistic, country-centred railroad companies. As a result, the U.K. model of privatized rolling stock and state-operated infrastructure more closely fit the cultural and social paradigm emerging in the EU and was thus being adopted cautiously and to differing degrees throughout the EU. During the latter half of the 1990s, public sector funding gradually shifted from supporting nationally subsidized rail systems to include more significant involvement from local municipal governments and the private sector. The belief was that by shifting to private ownership of rolling stock, the railway industry would eventually emulate the automobile or air transport models. Airlines worked with governments to secure terminals and immediate air space

[3]Andersen, Svein and Eliassen, Kjell (2001), *Making Policy in Europe,* London, Sage, p. 72.

Exhibit 3 Growing Privatization of the European Union Rail Industry

Source: Company files.

and runways, while operating and maintaining their own or leased airplanes. In effect, the airlines rented the infrastructure. Many believed that rail companies should operate in a similar fashion.

High-Speed Trains By the early 2000s, the European Commission continued to rank the development of a European-wide high-speed train infrastructure as its highest investment priority in transportation infrastructure. The Community of European Railways (COER), a continent-wide association of railway companies, asserted that high-speed rail services were especially appropriate for the 200 kilometre to 300 kilometre distances between heavily populated urban centres. Most of Europe fit this profile with mobility increasing as the prospects of a single European market progressed. But for Europe to fully benefit from the one market model, decisions in infrastructure policy required a European, and not a nationalistic, approach. However, many predicted that the tendency for governments to protect national producers would be detrimental to the continent-wide objectives for many years to come.

Customers The privatization of many national railways had changed the financing arrangements and customer base within the European rail car industry. In the past, manufacturers like BT sold directly to government operated railroads. However, with the privatization of rolling stock operations increasing in Europe, leasing arrangements were now available to operators. In the United Kingdom, equipment manufacturers sold to one of three large rail equipment leasing companies (ROSCO) owned by one of three large British banks (Bank of Scotland, HSBC or Abbey National Bank) which then leased the new rolling stock to the train operators. This lease-versus-purchase option reduced up-front costs for rolling stock operators and significantly decreased their overall capital requirements. It also put a premium on standardized trains—necessary to protect residual values. This, in turn, significantly reduced the incentives to purchase rolling stock from within a rail operators' home country.

In countries with private rail operators, revenues were generated through ticket sales and government subsidies while expenses were incurred through infrastructure franchise fees, day-to-day train maintenance, fuel and labor costs and leasing expenses. Since leasing costs on old, existing stock were much cheaper than on new equipment, operators preferred to delay purchases for as long as possible. When equipment was ordered, rail operators would sometimes seek additional delays by complaining that delivered equipment suffered from low reliability, which prevented it from meeting defined service standards the operators had committed to achieve in order to gain the concession from the government to operate the train service. This, in turn, caused manufacturers to incur late delivery charges and inventory costs as rail cars piled up in shipping yards awaiting minor repairs or adjustments. Many observers believed that these dysfunctional practices would be repeated in other European nations as they evolved to private operating models.

DaimlerChrysler and Adtranz History

Although the roots of Chrysler go back to 1920 in the United States, the history of Daimler-Benz dates to the 1880s in Germany and to the efforts of two inventive engineers—Gottlieb Daimler and Carl Benz. After a series of initiatives, Daimler-Benz was officially incorporated in 1926 and began producing cars under the Mercedes Benz brand.

By the 1980s, competition in the global automobile market had increased dramatically, and Daimler-Benz was looking to diversify its business. Between February 1985 and February 1986, the company acquired three conglomerates[4] for a combined US$ 1.11 billion. The cash expenditures of these 1985/86 acquisitions put a strain on its

[4]Daimler owned 50 per cent of Motoren-und-Turbinen-Union (a manufacturer of aircraft engines and diesel motors for tanks and ships) and bought the remaining 50 per cent for $160 million. Daimler purchased 65.6 per cent of Dornier (a privately held manufacturer of spacecraft systems, commuter planes and medical equipment) for $130 million. Daimler additionally purchased control of AEG (a high-technology manufacturer of electronic equipment, such as turbines, robotics, data processing and household products) for $820 million.

balance sheet, and by mid-1993, Daimler-Benz reported its first loss since the Second World War. In 1994, operations recovered somewhat with the company showing US$750 million in profits. But in 1995, the company's fortunes sagged again as it reported a loss of US$4 billion—the largest in German industrial history.

In 1995, Daimler-Benz's chief executive officer (CEO), Edvard Reuter, was forced to resign and was replaced by the aerospace division head, Jurgen Schrempp. One of Schrempp's first moves as CEO was the acquisition of 50 per cent of the rail division of Swedish–Swiss ABB Asea Brown Boveri Ltd. in exchange for US$900 million cash from Daimler-Benz. This joint venture formed the new ABB Daimler-Benz Transportation (Adtranz). Adtranz would become the largest rail service provider in the world with annual sales of US$4.5 billion.

By the mid-1990s, Robert Eaton had assumed the position of CEO at Chrysler at a time when the economic conditions in the automobile industry included an excess manufacturing capacity and an Asian economic crisis. Industry analysts were projecting an annualized global overcapacity of 18.2 million vehicles by the early 2000s. It came as no surprise that both Eaton and Schrempp were seeking partners due to the inevitable consolidation within the industry.

DaimlerChrysler AG was formed in November of 1998 when Daimler-Benz and Chrysler merged in a US$37 billion deal. In 1998, the newly formed company had revenues of US$130 billion, factories in 34 countries and sales of 4.4 million vehicles making it the fifth largest automobile manufacturer in the world. In 1999, DaimlerChrysler acquired the remaining 50 per cent of Adtranz from ABB for US$472 million.

Adtranz

Although the name Adtranz dates back only as far as 1995, the multiple production facilities that comprised the company date back to the 19th century. By the time of the DaimlerChrysler merger, the rail business in Europe had narrowed to four primary players: Alstom (France), Siemens (Germany), Adtranz and Bombardier. Unlike Altsom and Siemens, which had strong single country affiliations, Adtranz facilities and staff were a collection of multiple companies in multiple countries across the continent. Many of these companies also had a history of unstable ownership. For example, since 1989, the Adtranz facility in Derby, England, had experienced the following ownership changes: 100 per cent British Rail Engineering, then 40 per cent ABB, 40 per cent Trafalgar Rail and 20 per cent employee ownership, then 100 per cent ABB, then 50 per cent Daimler Chrysler and 50 per cent ABB and finally 100 per cent DaimlerChrysler. Each new ownership group brought its own philosophies to manufacturing, sales, contract tendering, personnel, etc. Mark Cooper commented on the cultural challenges in Adtranz:

> I don't think that Adtranz has had enough time to fully develop its own culture. Every two years there seems to have been a change of ownership, a change in structure, a change in values, and a change in processes. So under those circumstances you don't get a good sense of who you are.

In the late 1990s, Adtranz represented less than three per cent of DaimlerChrysler's revenues. Revenues of US$3.3 billion were recorded at Adtranz in 1999, and in 2000, after years of continual losses, Adtranz reported its first year of break-even results. Although Adtranz revenues were up over 15 per cent in 2000, the annual revenue growth over the previous four years averaged only 4.5 per cent. Given the complexity of the business and its peripheral role in DaimlerChrysler's overall strategy, many observers believed DaimlerChrysler would eventually divest its rail business.

Production Challenges Although DaimlerChrysler's assembly process and knock-down capabilities had been introduced, Adtranz's reputation for producing high quality products was poor. In particular, Adtranz was having quality, reliability and certification problems with its core Electrostar and Turbostar model trains designed for the U.K. market (see Exhibit 4). In 2000, the Electrostar model had only eight trains in service as customers

Exhibit 4 Bombardier's Electrostar

Intercity Transport

Electrostar Electric Multiple Unit, Class 375/377*

United Kingdom

Bombardier Transportation is responsible for supplying 182 Class 375/377 Electrostar* trains to the UK Govia owned rail operator, South Central Ltd. These state of the art, air-conditioned electric trains are either three or four cars in length. Each vehicle has two wide sliding powered doors per side capable of handling the passenger densities and flows required by busy urban and sub-urban services.

The trains operate at speeds up to 160 km/h on suburban services south of London. 15 of the 4-car trainsets are dual voltage capable of both 25 kV AC 50 Hz overhead and 750 V DC third rail operation. The remaining 167 electric trainsets in 3 and 4-car formations are single DC voltage only.

Particular attention has been paid to the provision of a high degree of reliability, safety and maintainability whilst ensuring low whole life costs.

The Class 375/377 Electrostar trains have a high level of passenger comfort with a very quiet interior environment and are fully compliant with the requirements of the Disability Discrimination Act. A modern passenger information system linked to the Global Positioning System relays messages in both visual and audible form. Each car will be fitted with a closed-circuit television surveillance system for enhanced internal security, allowing the driver to view car interiors whilst the train is stationary.

BOMBARDIER
TRANSPORTATION

Source: Company files.

were refusing to accept this train. Reliability was achieved under the terms of the contract.[5] The Turbostar had 279 trains in service, but only 86.5 per cent were available for operation. Reliability was also not achieved under the terms of the contract. Deciphering the causes of these reliability problems was a challenge for BT managers. Neil Harvey, director of public affairs at BT, provided one common interpretation:

> In terms of the reputation of Adtranz's products and its overall reputation as a company, many believed there was a certain amount of mismanagement. In particular, some felt that too many contracts were being bought, and there was often very poor follow-through on products, production and subsequent support.

In addition, Adtranz's customer support function and its initial contract bidding processes were viewed by some as inadequate. Many at BBD believed that Bombardier's structured governance system, manufacturing controls and proven bidding systems would be excellent complements to Adtranz.

A Strategic Acquisition for Bombardier

Despite awareness that certain management practices needed adjustment, BBD viewed the acquisition of Adtranz as a smart strategic move for several reasons. Europe is the nexus of technological advances in the industry. Asia and South America primarily utilized European engineering concepts and had a history of failing to develop new technologies on their own. North American trains were too heavy and, hence, more expensive and costly to operate compared to the refinements in other world markets and therefore not competitive. Also, the green movement and strong government support signaled long-term growth in the demand for rail transportation in Europe.

[5] Reliability is measured as the total distance travelled by the rail car between breakdowns. The total performance of all rail cars is then averaged together to get the mean reliability number as a factor of distance travelled by each train model. This is then measured in subsequent periods to evaluate performance and reliability levels going forward.

Not only did BBD find the European rail market attractive, but it was increasingly interested in balancing the revenue streams produced by its various groups. Strengthening the company's rail business was viewed as an important move to counter- balance Bombardier's growing, but cyclical, aerospace group. Dr. Yvan Allaire, executive vice-president at BBD, explained this strategic perspective: "Bombardier's value for shareholders is as a premium diversified company, not as an aerospace company."

Although margins were often lower in rail (in 2000, margins for the aerospace group were 11 percent—more than twice that of the transportation group), the industry benefited from the traditional business practice of advance and progress payments from customers. These payments translated to a low level of net utilized assets and very positive cash flow, contingent on a growing backlog of orders. These cash flows provided BBD with capital that was utilized throughout the company. Allaire explained this possibility:

> Transportation is a huge cash generator. While the margins are low, cash is large in this business. In fact, we have traditionally financed a large part of the investment in the aerospace sector from cash coming from transportation. A lot of people don't understand this.

Although low-margin businesses traditionally had profit levels driven by cost control, in the rail transportation industry, variability and project management performance were additional key drivers. For example, penalty charges for late delivery of each car generally amounted to 10 per cent of the value of such car. In comparison, period costs in sales, general and administration (SG&A) accounted for six per cent of expenses. Preliminary investigation by BT managers indicated that repair and late delivery charges amounted to nearly 20 per cent of Adtranz's expenses. By applying BT's production and cost control systems, it was thought that acquiring Adtranz would provide substantial upside potential to raise profits.

Finally, BT had a strong reputation for its expertise in subway, trams and light rail cars. Adtranz had expertise in propulsion systems, high-speed and inter-city cars and signaling systems. While the acquisition would clearly strengthen Bombardier's global reach, it would also bring needed technology and product expertise to the electrical locomotive, high-speed train, propulsion, and train control/communications. Closing this gap was becoming an imperative in Europe. For instance, in 2000, Bombardier was precluded to bid on the largest order ever awarded in the United Kingdom because Siemens, Alstom and Adtranz had refused to sell the propulsion system to them. In addition, Adtranz—at over twice the size of BT—would add $2.7 billion in backlog to maintenance and services while providing more service facilities for customers in the European marketplace.

The Acquisition

Financial analysts had anticipated that DaimlerChrysler would seek a sales price of 25 per cent to 30 per cent of 1999 revenues of US$3.3 billion. However, ongoing problems in DaimlerChrysler's automobile business may have hastened their unloading of the non-core asset. Although Alstom and Siemens were BBD's main competitors in the rail industry, neither competed to acquire Adtranz in part because of the beliefs that the European Commission would probably not approve of the merger due to their current strong positions in several market segments.

On August 4, 2000, BBD announced its intention to buy Adtranz for US$715 million. In its negotiations with DaimlerChrysler, BBD agreed to pay the purchase price in two installments of cash—one at closing and one six months later. Under the deal, Bombardier also agreed to the assumption of certain debt. For the deal to proceed, regulatory approval was notably required in both the EU and the United States. Given the complimentary operations of both companies in the United States (mechanical versus propulsion), U.S. approval was never a significant issue. However, matters were different in Europe where it was initially estimated that the approval process would take between four and six months.

In negotiating the deal, DaimlerChrysler insisted on a limited due diligence process. In response, it was determined that any disagreement between the asset valuation done by BBD and the value given by DaimlerChrysler would lead to adjustments in a manner agreed upon; however, if adjustments exceeded a given amount, BBD could claim that there had been a material adverse change. This disagreement would then be submitted to an independent arbitrator for adjustment. Allaire commented on the limited due diligence process:

> It was certainly the first time that Bombardier agreed to go into an acquisition without first doing full due diligence. DaimlerChrysler basically said, "Look, have your people do an initial review and don't worry about the rest—we'll give you an equity guarantee. Adjustments will have to be made to the price if the provisions already taken in our books are not sufficient."

DaimlerChrysler had good reasons for wanting to limit the due diligence process. A new management team had just been put in place and was supposedly making progress streamlining Adtranz's operations. It was a natural concern that the management team would be seriously demoralized if Bombardier was invited in, only to later walk away from the transaction. And, secondly, Adtranz had serious worries about opening their books to a direct competitor. For Bombardier to come in and examine their pricing, cost structure, contracts and so on would have been off-limits under EU competition rules governing mergers and acquisitions.

Negotiations with the European Commission

With the negotiations complete, BBD then applied to the EC for regulatory approval. Since 1990, the system for monitoring merger transactions in Europe has been governed by the Merger Regulation Committee of the European Commission. The Merger Regulation Committee eliminated the need for companies to seek approval for certain large-scale mergers in all European countries separately and ensured that all such merger requests received equal treatment. The control of mergers and acquisitions was one of the pillars of the EU's competition policy. When companies combined through a merger, acquisition, or creation of a joint venture, this generally had a positive impact on markets: firms became more efficient, competition intensified and the final consumer benefited from higher quality goods at lower prices. However, mergers that created or strengthened a dominant market position were prohibited in order to prevent abuses. A firm was in a dominant position when it was able to act on the market without having to account for the reactions of its competitors, suppliers or customers. A firm in a dominant position could, for example, increase its prices above those of its competitors without fearing any significant loss of sales.

In order to merge competing companies in Europe, the approval of the EC's merger task force was required. A review was comprised of two phases. Phase 1 involved a preliminary review, although full approval could be granted at this stage. Should Phase 1 identify potential competitive issues or conflicts associated with the proposed merger, a deeper investigation proceeded to Phase 2. This second phase could take months or years to complete as the depth and breadth of the investigation increased.

While many mergers were ultimately approved by the EC merger task force, this was in no way guaranteed. During the prior year, Alcan's proposed purchase of Pechiney was turned down by the task force. And GE's proposed acquisition of Honeywell was facing growing opposition. With this track record, some feared that the EC might have a bias against North American companies buying European businesses.

BBD utilized a negotiation strategy that it hoped would prove successful in gaining regulatory approval. It identified potentially contentious issues in advance and developed tactics to minimize disagreement. In order to comply with the likely EC demands, BBD volunteered to divest non-strategic transportation assets in Germany and, to extend for several years a series of supply contracts with smaller companies based in Austria and Germany. BBD was the main customer for these small suppliers and, with the acquisition of Adtranz, technologies previously purchased from these companies could now be manufactured within the newly assembled Bombardier/Adtranz. The few years of continued sales to BBD allowed these small companies to transition into new industries or to find new customers.

On a separate matter, BBD realized that the market share of the combined companies might be an issue for certain product segments in certain countries and so tried to shape the focus of the merger task force to the European market in total and not to any specific country. Primary geographical areas of concern were Germany, Austria and the United Kingdom. The German market was a key area with annual sales over US$1.8 billion; in Germany, Bombardier/Adtranz would have had a 50 per cent share. Concessions were made to ensure that a third competitor (Stadler) was allowed to strengthen its position in the German regional train market. Allaire, who led the negotiating team at the EC, commented on the efforts to win regulatory approval.

> You always have to make concessions—that's part of the deal over there. You don't get through the EC review process without some concessions unless you are buying something totally unrelated. But if there is any relatedness, the acquiring party must come up with concessions that will make the transaction acceptable.

For BBD, the preliminary result of the negotiation was not a Phase 1 approval, but a shortened Phase 2 process because issues were identified in Phase 1 and solutions were already designed. BBD believed, in March 2001, that Phase 2 would conclude within a month or so of further negotiations. While BBD was pleased with the results of its efforts to this point, the company had no firm guarantees that the transaction would be approved, or if approved, under what final conditions and timelines.

Pierre Lortie

A graduate of Université Laval (Canada) and Université de Louvain (Belgium), Pierre Lortie was both an engineer and an economist by training. He also received an MBA with honors from the University of Chicago. Prior to taking over BT, Lortie had been president and chief operating officer of Bombardier Capital (2000–2001). He had also been president and chief operating officer of Bombardier International (1998–2000), president of Bombardier Aerospace, Regional Aircraft (1993–1998), and president of Bombardier Capital Group (1990–1993). Before joining Bombardier in 1990, Lortie had been chairman, chief executive officer and president of Provigo Inc.—a major, Quebec-based retailer (1985–1989)—and president and chief executive officer of the Montreal Stock Exchange (1981–1985).

Over the years, Lortie had developed a reputation within BBD as a turnaround expert. His movements throughout BBD corresponded with the transformation of under-performing businesses into market leaders within a few years of his taking the helm. His philosophy included a combination of approaches: strong and decisive leadership, hands-on management, good relationships with existing personnel and the development of pride within those on the team. He also believed in the importance of rapidly achieving small, visible wins in order to build the support necessary to make subsequent larger changes. Lortie summarized his approach:

> You have to figure out the business model and focus everything on the key factors. You also have to work with the people . . . making sure they are focusing on what has to be done . . . helping them, coaching them and removing roadblocks. You should never forget that people like successes and being on the winning team.

Lortie recognized that his style and methods of change management were in some ways different than approaches taken by others in turnaround situations. Although aware of the need to streamline costs, he did not follow the traditional approach of implementing massive, short-term, cost-cutting tactics as an initial step in the turnaround plan. Instead, he focused first on creating a healthy operating environment through the implementation of reporting and governance systems aimed at monitoring key metrics and assessing current and potential success. His main objective was to ensure a balance between cost reduction or restructuring initiatives and revenue growth. He strongly held the view that balance was necessary because halting growth would hurt the market performance of a company far more than would a failure to rapidly reduce costs.

In promoting change, he not only engaged and empowered people at all levels, he also sought to create the trust and credibility necessary for a leader to implement further, more difficult changes that may be required based on assessment of the metrics. Lortie commented on the rationale behind his move to BT:

> My job at Bombardier has been to turn around operations that were not doing well. This is what I did at Bombardier Capital and Regional Aircraft. When Bob Brown [CEO of BBD] asked me to take over the job at transportation, he was concerned that there were difficulties in the current transportation group and high expectations involving the Adtranz merger. He felt that the magnitude of the task of stitching together the two organizations and rapidly delivering acceptable performance required someone who had a track record. There was some concern that I had not been at Bombardier Capital long enough to complete the restructuring process I had set in motion. But Adtranz was going to be Bombardier's biggest acquisition ever and getting it right seemed to be more important than keeping me at Capital.

Determining a Course of Action While Lortie was a veteran of Bombardier and had participated in the strategic plan and budget reviews of the group over the years, he admitted knowing relatively little about Bombardier Transportation operations, per se. But he was convinced that the process for building and operating trains was not dissimilar to commercial aircraft. Many of the key success factors were thought to be the same. Beyond this core belief, Lortie faced an overwhelming number of decisions. He summarized the long list.

> What was the best way for us to leverage the potentially increased size of Bombardier Transportation?

Should we take a top line approach to results or a bottom line approach? How can we tailor the integration to balance revenue and cost initiatives? How do we reconcile the fundamentally incompatible organizational structures, particularly in Europe? How do we go about designing the "best" organizational structure under the circumstances? How should we proceed to approve new bids [those arising in the first few weeks and longer term] and ensure they are profit-making propositions? How should we develop and instill a project management culture in an organization that has no such tradition (or lost it)? How do we get management focused on the operations, on "getting it right," avoid finger pointing at former Adtranz management, create a climate conducive to teamwork while conducting a thorough due diligence of all Adtranz contracts and operations? How and when should Bombardier integrate its manufacturing philosophies into the existing Adtranz operations? What should Bombardier do to minimize tensions and maximize teamwork with personnel changes imminently on the horizon? How should those personnel changes be made? Who, in the management ranks of Adtranz and BT, should I keep and who should I replace and how should I go about the process of making these decisions? Should the headquarters of the merged companies be located in St. Bruno, Quebec, Berlin or a more neutral city like Brussels, Paris or London? And finally, what kind of style should I use in leading the organization forward? How directive should I be versus participative in making decisions?

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Case 4-4 World Vision International's AIDS Initiative: Challenging a Global Partnership

On January 19, 2002, Ken Casey, director of World Vision International's HIV/AIDS Hope Initiative, walked into a safari lodge in South Africa to present the final session of a conference attended by 40 senior staff from 17 countries with the highest prevalence of HIV and AIDS in Africa and nearly 20 senior executives from worldwide support offices. As he stretched his back, he felt a sharp pain from wounds he had received during a vicious attack by a baboon on the hotel's patio the day before the conference began. Badly cut and bruised, Casey had staggered to the conference center where he had been wrapped in towels and rushed to a hospital. It had required 135 stitches and 27 staples to close the wounds.

Determined to proceed with the conference, which he saw as a potential turning point in his year-long struggle to get the Hope Initiative off the ground, Casey had returned the next day. Largely driven by the senior leaders of World Vision International, the initiative was an ambitious attempt to implement common goals and strategies in fund-raising, programming, and advocacy across the 48 independent members of the World Vision Partnership. But its future was unclear. Not only did its focus on HIV/AIDS represent a major shift in World Vision's programming, but in many ways, the initiative's top-down implementation challenged the federated organization model the partnership had pursued throughout the 1990s. As he addressed the

Professor Christopher A. Bartlett and Daniel F. Curran, Director—Humanitarian Leadership Program, prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

conference, Casey worried that if it did not go well, the Hope Initiative might well be dead in the water.

Birth of World Vision International

World Vision International was a $1 billion Christian relief and development partnership linking 48 national members in a global federation. In 2002, the partnership raised over $732 million in cash and nearly $300 million in commodities. (See **Exhibit 1** for representative World Vision Partnership financial data.) Almost 50% of World Vision's funding flowed from private sources, mostly through child sponsorship. Governments and multilateral agencies provided the other 50%.

A Visionary Founder: "Faith in Action" Founded in the United States in August 1950 by Bob Pierce, a Christian evangelist who was moved by the suffering he witnessed in Korea, World Vision was funded by North American Christians whom Pierce connected to individual Korean orphans through photographs and personal correspondence. This innovative sponsorship program—later widely imitated—helped Pierce translate the massive needs he saw in Asia into personal terms in America. In 1952, the organization's first statement of purpose read: "World Vision is a missionary service organization meeting emergency needs in crisis areas of the world through existing evangelical agencies."

Although Pierce cultivated a small, dedicated staff, he called the shots in his young organization. He challenged his team by telling them, "Cut through the reasons why things can't be done. Don't fail to do something just because you can't do everything."[1] With this entrepreneurial attitude, Pierce soon extended World Vision's work into Hong Kong, Indonesia, Taiwan, India, and Japan.

By the 1960s, World Vision was opening offices in other countries. In 1961, an affiliate office opened in Canada as a separate national entity, and in 1966 a national entity was established in Australia. During this period, it also refined its "child sponsorship" model and, by the mid-1960s, was supporting 15,000 children in Southeast Asia. Responding to church film screenings, radio advertising, and direct-mail appeals, Christians in the United States, Canada, and Australia were promised a loving connection to a poor child in the developing world for a monthly contribution of around $10. Full-time staff and hundreds of volunteers coordinated the delivery of photos and letters between children and sponsors, while more than a dozen marketers created appeals to attract more donors. It was a successful process requiring a great deal of administrative support.

By 1969, World Vision managed $5.1 million in funding of which 80% was delivered to 32,600 children in 388 projects. The remaining 20% supported fund-raising and administrative costs. All funding and most support services flowed through the headquarters offices in Monrovia, California. As the war in Vietnam began absorbing the organization's energy, significant changes in approach occurred. Instead of working through existing orphanages and ministries, World Vision staff opened refugee schools, recruited and trained local teachers, and built houses for the displaced.

A New Leader, A New Approach: The Evolving Mission

Toward the end of the 1960s, however, World Vision began experiencing difficulties. A senior executive described the emerging problems: "Anyone looking at World Vision would see an organization that reflected Bob Pierce himself: action oriented, strongly evangelical, innovative, and progressive. But we had no long-range planning or adequate mechanisms for administration." But Pierce strongly resisted changes that many felt were needed. As money became short, tensions grew between him and his board. Finally, in 1967, Pierce resigned.

Pierce's successor, Stan Mooneyham, was another action-oriented risk taker. With the fall of South Vietnam and Laos and the rise of the Khmer Rouge in Cambodia, World Vision lost contact with much of its program staff in those countries. More importantly, nearly 30,000 sponsors lost contact with their sponsored children. But the four core

[1] Graeme Irvine, *Best Things in the Worst Times: An Insider's View of World Vision* (Wilsonville, OR: World Vision International, 1996), p. 18.

Exhibit 1 World Vision International FY2002 Financial Data

PARTNERSHIP INCOME FY2002
(Offices receiving $200,000 or more in thousands of U.S. dollars)[a]

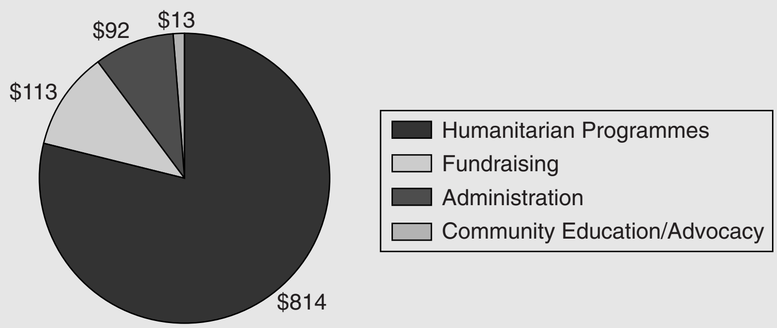
National Offices	Contributions	Gifts-in-Kind	Total
Armenia	$ 360		$ 360
Australia	78,543	$ 14,844	93,387
Austria	2,121	543	2,664
Brazil	2,786		2,786
Burundi	205		205
Canada	105,656	38,924	144,580
Chad	339		339
Chile	265		265
Colombia	1,041		1,041
Costa Rica	274		274
Finland	1,407	—	1,407
Germany	34,370	2,987	37,357
Haiti	331		331
Hong Kong	25,885	1,237	27,122
India	1,214		1,214
Indonesia	219		219
Ireland	4,538		4,538
Japan	12,055	2,294	14,349
Korea	20,802	1,282	22,084
Malaysia	918		918
Mexico	1,410		1,410
Myanmar	213		213
Netherlands	3,973	372	4,345
New Zealand	13,459	21	13,480
Philippines	505		505
Sierra Leone	1,287		1,287
Singapore	2,615	—	2,615
South Africa	507		507
Switzerland	12,599	704	13,303
Taiwan	31,221	75	31,296
Tanzania	722		722
Thailand	3,707		3,707
United Kingdom	46,529	1,199	47,728
United States	317,744	235,086	552,830
Zambia	1,030		1,030
Other Offices	1,185		1,185
Total Partnership Income	**$732,035**	**$299,568**	**$1,031,603**

[a] In approximate U.S. dollars. Exact amounts depend on time currency exchange is calculated.

(continued)

Exhibit 1 *(concluded)*

Use of Resources FY2002
(in cash and gifts-in-kind in millions of U.S. dollars)



What World Vision's resources accomplish:

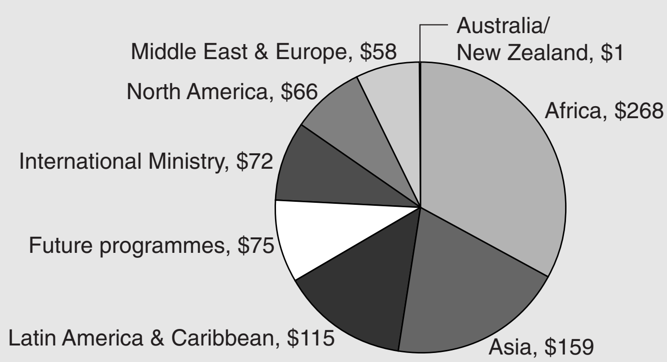
Humanitarian Programmes provide for emergency relief in natural and man-made disasters and for development work in food, education, health care, sanitation, income generation and other community needs. Also included are the costs of supporting such programmes in the field.

Fundraising supports humanitarian programmes by soliciting contributions through media and direct marketing appeals. Included are costs of marketing, creative services and publishing materials.

Administration includes donor relations, computer technology, finance, accounting, human resources and managerial oversight.

Community Education/Advocacy promotes awareness of poverty and justice issues through media campaigns, forums, speaking engagements, and public advocacy.

Ministry Support & Programmes by Region FY2002
(in case and gifts-in-kind in millions of U.S. dollars)



Source: World Vision International 2002 Annual Report.

fund-raising offices—in the United States, Canada, Australia, and New Zealand—found that most of their donors were willing to transfer their assistance to children elsewhere. The organization shifted its focus to Latin America, establishing offices and sponsorship programs in Brazil, Colombia, Ecuador, Guatemala, and Mexico.

At the same time, some in the organization began questioning the sustainability of World Vision's traditional model of selecting and supporting individual children. At a conference in 1971, Gene Daniels, WV director in Indonesia, proposed an alternative model of rural community development. Undeterred by the lukewarm reception his ideas received, for the next two years Daniels quietly experimented with this community development–based approach. As he began to succeed, others voiced an interest. Graeme Irvine, president of World Vision-Australia, supported a shift to longer-term commitments rather than "dump and run" emergency relief. He stated, "Development is not something you do for people. Those who wish to help may walk alongside, but not take over."[2]

Influenced by these voices, in 1972, Mooneyham promised that World Vision would build a Christian Children's Hospital in Phnom Penh. He presented a proposal to the international board but was disappointed to be turned down. Then the presidents of World Vision-Australia and World Vision-New Zealand offered to organize staff and fund the program themselves. Six months later, when World Vision opened the hospital in Phnom Penh, Mooneyham wrote, "The Cambodia medical program was an example of World Vision's emerging international partnership at work. It illustrated our principle of looking for alternative solutions to major problems."[3]

In 1973, following a series of consultations, the World Vision Board made a commitment to both relief and development in World Vision's mission. But the consensus over becoming a "transform" rather than a "transfer" organization meant significant changes to the structure and governance. "What you are doing in development is according people the dignity of voice and self-determination," stated Irvine. "But a big organization like World Vision has all kinds of baggage—bureaucracy, systems, reports, layers of authority, policies and many committees—that got in the way of development. How would we work as a partnership?"[4]

Moving Toward Partnership: Forming WVI Until the early 1970s, World Vision's U.S. organization, as the founding country and by far the largest contributor, had made most of the significant programming decisions. Under its guidance, the overall organization had expanded beyond Asia and Latin America into Africa and the Middle East. Typically, each initiative had arisen from special circumstances or through initiatives led by interested groups, churches, or individuals.

Increasingly, however, the presidents of Canada, Australia, and New Zealand—the other key fund-raising (support) offices—wanted to move beyond just providing funds to program-delivery (field) offices. They wanted to participate in policy and strategy decisions. "This was not so much a desire for control as it was a need for accountability to donors," explained a World Vision-NZ executive. In 1973, Mooneyham responded by forming a study committee to recommend a basis for "a true partnership among all national entities: a partnership of both structure and spirit."

Over the next few years, the committee met to define the issues and consider the options. "At the core we saw it not as structure or even as process, but an attitude toward each other that did not view one partner as superior to any other," stated one committee member.[5] Finally, in April 1976, the international board unanimously decided to form a new distinct entity, World Vision International (WVI), as the common program-delivery arm of World Vision's four main fund-raising support offices—the United States, Canada, New Zealand, and Australia. The directors of each sat on the

[2]Irvine, p. 71.
[3]Irvine, p. 45.
[4]Irvine, p. 72.
[5]Irvine, p. 136.

international board. (World Vision-U.S. maintained the World Vision name and trademark but gave its WVI partners the right to use them.) World Vision national entities in developing countries (the field offices delivering the programs) became members of WVI's council but did not have equal-partner status with the four board members. The council agreed to WVI's mission and, in May 1978, adopted a formal declaration of internationalization.

Building the World Vision Partnership: Defining a Federation

To provide coordinated management of the global field operations funded by the core support offices, WVI's council created a central international office, colocated with the World Vision-U.S. office in Los Angeles. However, rather than functioning as a servant to the four council member organizations, it soon became a separate power base. A WVI manager at the time recalled:

> Mooneyham brought all of the bright and creative folks with him to the international office, and this had two unintended consequences. First, as the program-delivery mechanism became the dominant force in the organization, the value and importance of the fund-raising team left in the WV-U.S. was eroded. Second, because this organization separated its "marketing" and "production" functions, each group developed its own culture.

The separation lasted for almost a decade during which time the national directors of the largest support offices, again feeling frustrated at just delivering the funds they raised to the international office, started to demand more of a say in strategy. Said one senior WVI manager, "Our core competitive advantage—what we did particularly well—was our child sponsorship mechanism. It was the most sustainable form of fund-raising, and we had become one of the best in the world at doing it. But, at that time, we did not recognize it. No wonder they were frustrated."

Challenging Central Control When Tom Houston became the new president of WVI in 1984, his attention was drawn to the devastating drought in Ethiopia. The global response from donors was staggering. Under agreements with the U.S. government and U.N. agencies, WVI's Ethiopia response budget grew from \$2.3 million in 1984 to \$43.4 million in 1986. To manage the funding, World Vision's staff in Ethiopia grew from 100 to 3,650. In the following year, WVI launched 11 large development projects in six other African nations. Because of the need for coordination, all logistics and program functions were managed from the international office, giving even more power to this fast-growing group.

By 1987, World Vision had survived and grown through a decade of expansion. But there was discontent within the organization, and Houston discovered that the unhappy support-office directors were meeting together informally to share their frustrations. "Tom was abrupt and frank and did not like the notion of a dominant person pushing the little guys around," said one executive. "So he turned our culture upside down." To bring the support-office directors into the inner circle, he asked several of them to sit on the international planning committee, the president's primary consultative group on partnership decisions. In addition, he shook up the management of the international office by requiring that all regional vice presidents come from their regions.

But frustration reached a boiling point in August 1987 when national directors responsible for the work in over 60 countries gathered at a director's conference in Sierra Madre, California. When, as was the norm at these events, executives from the international office began to deliver presentations on strategy and operations, three new regional VPs from Brazil, Nigeria, and Egypt stood together. "If this is a director's conference, why are we working on your agenda?" they asked. The directors of the main support offices joined the "revolt." Recognizing the legitimacy of the challenge, Houston surrendered the agenda. Following the conference, 30 senior executives spent a year studying how to redefine the relationship between field and support offices and the international office.

Creating Area Development Programs Meanwhile, the 11 large-scale development programs World Vision had launched in 1985 were struggling. Each had a budget of more than $1 million, a time span of more than three years, and a geographic scope greater than a single community. The causes of the problems were diagnosed as unrealistic initial expectations, lack of local management and technical expertise, and a top-down planning and control system.

A study commissioned to propose solutions to these problems recommended a new approach that sought to retain the benefits of scale while engaging more local involvement in community-level transformational development. Through the 1990s a new way to work, referred to as the Area Development Program (ADP), became the dominant means of program delivery for World Vision. In Africa, for example, over 300 ADPs were defined, each aiding 50,000 to 200,000 people. Wilfred Mlay, African regional vice president, explained their operation:

> Each ADP is managed by a coordinator from that country who understands the local language and customs. He or she negotiates an agreement with the community for a 10- to 15-year multisectoral engagement, then they sign a contract promising to work together. . . . Before, communities tended to consider the local projects—a bore hole, a school, a health center—as World Vision projects. If something went wrong, they said, "Come and fix your pump. Come and fix your vehicle." There was no ownership. . . . Now we don't just dig wells and provide clean water; we partner with each ADP area to identify root causes of their problems, then we work with them to provide a long-term program that will address the needs they identify. The strength of the approach is in finding local solutions to local problems.

Engaging Federalism When Houston resigned as WVI's president in 1988, Irvine, former head of World Vision-Australia, took his place. Upon his appointment, Irvine made a commitment to make WVI "a professional, enlightened, efficient and humane organization [that] will nurture a climate of creativity in which people feel free to contribute."[6] He then launched a process to reexamine the organization's values, mission, and structure, all of which were to be open to challenge and change.

A working group developed a set of core values (see **Exhibit 2)** that was adopted by the board of World Vision International in 1990. Next, after 24 drafts, in 1992 the board adopted a new mission. Finally, Irvine led the creation of a Covenant of Partnership (see **Exhibit 3**) that was signed by all members of the newly defined World Vision Partnership. "We want to be held together by shared agreements, values, and commitments rather than legal contracts or a controlling center," said Irvine. "The covenant is a statement of accountability to each other, setting out the privileges and responsibilities of national member-entities of the World Vision family."

By 1995, with over a million sponsored children in its care—up from 70,000 children 15 years earlier—the World Vision Partnership decided to build its formal organizational architecture on a "federal" model. (See **Exhibit 4**.) Recognizing that that simple decentralization would mean losing economies of scale, the partnership made the goal of the new structure to try to make all partners as self-sufficient as possible but to maintain a strong core of common language, systems, and operations. Bryant Myers, senior vice president of operations, explained the philosophy:

> We wanted to combine the strength of the central organization with centers of expertise and action that existed around the partnership, balancing the contributions and needs of each. That should result in centralizing the things that can be done better and cheaper that way and decentralizing other things that can be managed more effectively on the front lines. . . . We learned that the biggest misreading of federalism is to call it decentralization. The key to federalism is to ensure the right of intervention held by the leader at the center.

Designing the Structure and Governance Under the resulting federal structure, membership in the WVI Partnership required a commitment to its core documents (mission statement, statement of faith, core values, and Covenant of Partnership), to WVI

[6] Irvine, p. 134.

Exhibit 2 Extracts from World Vision International's Statement of Core values

WE ARE CHRISTIAN We acknowledge one God; Father, Son and Holy Spirit. In Jesus Christ the love, mercy and grace of God are made known to us and all people. . . . We seek to follow him—in his identification with the poor, the powerless, the afflicted, the oppressed, the marginalized; in his special concern for children; in his respect for the dignity bestowed by God on women equally with men; in his challenge to unjust attitudes and systems; in his call to share resources with each other; in his love for all people without discrimination or conditions; in his offer of new life through faith in him . . .

WE ARE COMMITTED TO THE POOR We are called to serve the neediest people of the earth; to relieve their suffering and to promote the transformation of their condition of life. . . . We respect the poor as active participants, not passive recipients, in this relationship . . .

WE VALUE PEOPLE We regard all people as created and loved by God. We give priority to people before money, structure, systems and other institutional machinery. . . . We celebrate the richness of diversity in human personality, culture and contribution. . . . We practice a participative, open, enabling style in working relationships. We encourage the professional, personal and spiritual development of our staff.

WE ARE STEWARDS The resources at our disposal are not our own. They are a sacred trust from God through donors on behalf of the poor. We are faithful to the purpose for which those resources are given and manage them in a manner that brings maximum benefit to the poor. . . . We demand of ourselves high standards of professional competence and accept the need to be accountable through appropriate structures for achieving these standards. We share our experience and knowledge with others where it can assist them.

WE ARE PARTNERS We are members of an international World Vision Partnership that transcends legal, structural and cultural boundaries. We accept the obligations of joint participation, shared goals and mutual accountability that true partnership requires. We affirm our inter-dependence and our willingness to yield autonomy as necessary for the common good. We commit ourselves to know, understand and love each other. . . . We maintain a co-operative stance and a spirit of openness towards other humanitarian organizations. We are willing to receive and consider honest opinions from others about our work.

WE ARE RESPONSIVE We are responsive to life-threatening emergencies where our involvement is needed and appropriate. We are willing to take intelligent risks and act quickly. We do this from a foundation of experience and sensitivity to what the situation requires. We also recognize that even in the midst of crisis, the destitute have a contribution to make from their experience. . . . We are responsive to new and unusual opportunities. We encourage innovation, creativity and flexibility. We maintain an attitude of learning, reflection and discovery in order to grow in understanding and skill.

OUR COMMITMENT We recognize that values cannot be legislated; they must be lived. No document can substitute for the attitudes, decisions and actions that make up the fabric of our life and work. Therefore, we covenant with each other, before God, to do our utmost individually and as corporate entities within the World Vision Partnership to uphold these Core Values, to honor them in our decisions, to express them in our relationships and to act consistently with them wherever World Vision is at work.

Source: World Vision International internal documents.

ministry policies, and to the WVI trademark agreement. Organizationally, the partnership was governed through a set of linked structures (see **Exhibit 5**).

By 2002, there were 48 national partners, each with one vote on the **international council,** the partnership's highest authority. Held once every three years, council meetings were attended by the international board members, the chairs of the national boards or advisory councils, national office directors, and elected delegates from all partner offices. The council reviewed the objectives of World Vision International, assessed the accomplishment of previous goals, and made recommendations to

Exhibit 3 Extracts from World Vision's Covenant of Partnership

THE COVENANT (EXTRACTS)
Regarding World Vision as a partnership of interdependent national entities, we, as a properly constituted national World Vision Board (or Advisory Council), do covenant with other World Vision Boards (or Advisory Councils) to:

A. UPHOLD THE FOLLOWING STATEMENTS OF WORLD VISION IDENTITY AND PURPOSE:
The Statement of Faith
The Mission Statement
The Core Values.

B. CONTRIBUTE TO THE ENRICHMENT OF PARTNERSHIP LIFE AND UNITY BY:
Sharing in strategic decision-making and policy formulation through consultation and mechanisms that offer all members an appropriate voice in Partnership affairs . . .
Accepting the leadership and organizational structures established by the WVI Council and Board for the operation of the Partnership . . .
Fostering an open spirit of exchange for ideas, proposals, vision and concern within the Partnership . . .

C. WORK WITHIN THE ACCOUNTABILITY STRUCTURES BY WHICH THE PARTNERSHIP FUNCTIONS, by:
Affirming the principle of mutual accountability and transparency among all entities . . .
Accepting Partnership policies and decisions established by WVI Board consultative processes.
Honoring commitments to adopted budgets to the utmost extent possible . . .
Executing an agreement with World Vision International to protect the trademark, name and symbols of World Vision worldwide . . .

D. OBSERVE AGREED FINANCIAL PRINCIPLES AND PROCEDURES, especially:
Using funds raised under the auspices of World Vision exclusively in World Vision approved ministries.
Keeping overhead and fund-raising expenses to a minimum to ensure a substantial majority of the funds raised are responsibly utilized in ministry among the poor.
Accepting Financial Planning and Budgeting Principles adopted by the WVI Board.
Ensuring that funds or commodities accepted from governments or multi-lateral agencies do not compromise World Vision's mission or core values, and that such resources do not become the major ongoing source of support.

E. PRESENT CONSISTENT COMMUNICATIONS MESSAGES, that:
Reflect our Christian identity in appropriate ways.
Include words, images, and statistics that are consistent with ministry realities.
Avoid paternalism and cultural insensitivity.
Are free from demeaning and degrading images.
Build openness, confidence, knowledge and trust within the Partnership.
In signing the Covenant, we are mindful of the rich heritage of Christian service represented by World Vision and of the privilege which is ours to join with others of like mind in the work of the Kingdom of God throughout the world. We therefore recognize that consistent failure to honour this Covenant of Partnership may provide cause for review of our status as a member of the Partnership by the Board of World Vision International.

Signed in behalf of (NAME OF NATIONAL ENTITY)
by resolution carried at a meeting of the [Board] (or Advisory Council) on

____
Chair of [Board] (or Advisory Council)

Source: World Vision International internal documents.

Exhibit 4 Key Elements of the WVI Partnership

The World Vision Partnership refers to the entire World Vision family throughout the world. Any expression of the World Vision ministry is in some way connected to the Partnership. The word "Partnership" is used in this document in a broad, informal sense, rather than a legal sense.

World Vision National Entities comprise the membership of the Partnership. The conditions and categories of membership are described in the By-Laws of World Vision International. All function with the guidance and advice of a National Board or Advisory Council.

World Vision International (WVI) is the registered legal entity which, through its Council and Board of Directors, provides the formal international structure for the Partnership.

The WVI Council provides the membership structure for the Partnership. It meets every three years to review the purpose and objectives of World Vision, assess the extent to which they have been accomplished and make recommendations to the WVI Board in relation to policy. All member-entities are represented on the Council.

The WVI Board of Directors is the governing body of World Vision International as outlined in the By-Laws. The membership of the Board is broadly representative of the Partnership and is appointed by a process determined by the Partnership.

The International Office is the functional unit of World Vision International, housing most of the central elements of WVI. It operates under the authority of the WVI Board of Directors.

Source: World Vision International internal documents.

the board in relation to global strategies and policies.

World Vision's **international board** was composed of the international president and 23 directors selected from the governing bodies of WVI's national offices. It oversaw the partnership, meeting twice a year to appoint WVI's senior officers, approve strategic plans and budgets, and set international policy.

Seven **regional forums** were composed of representatives from the national boards or advisory councils of each national office in each region. They shared experiences on regional programs and strategies and nominated representatives to the WVI Board.

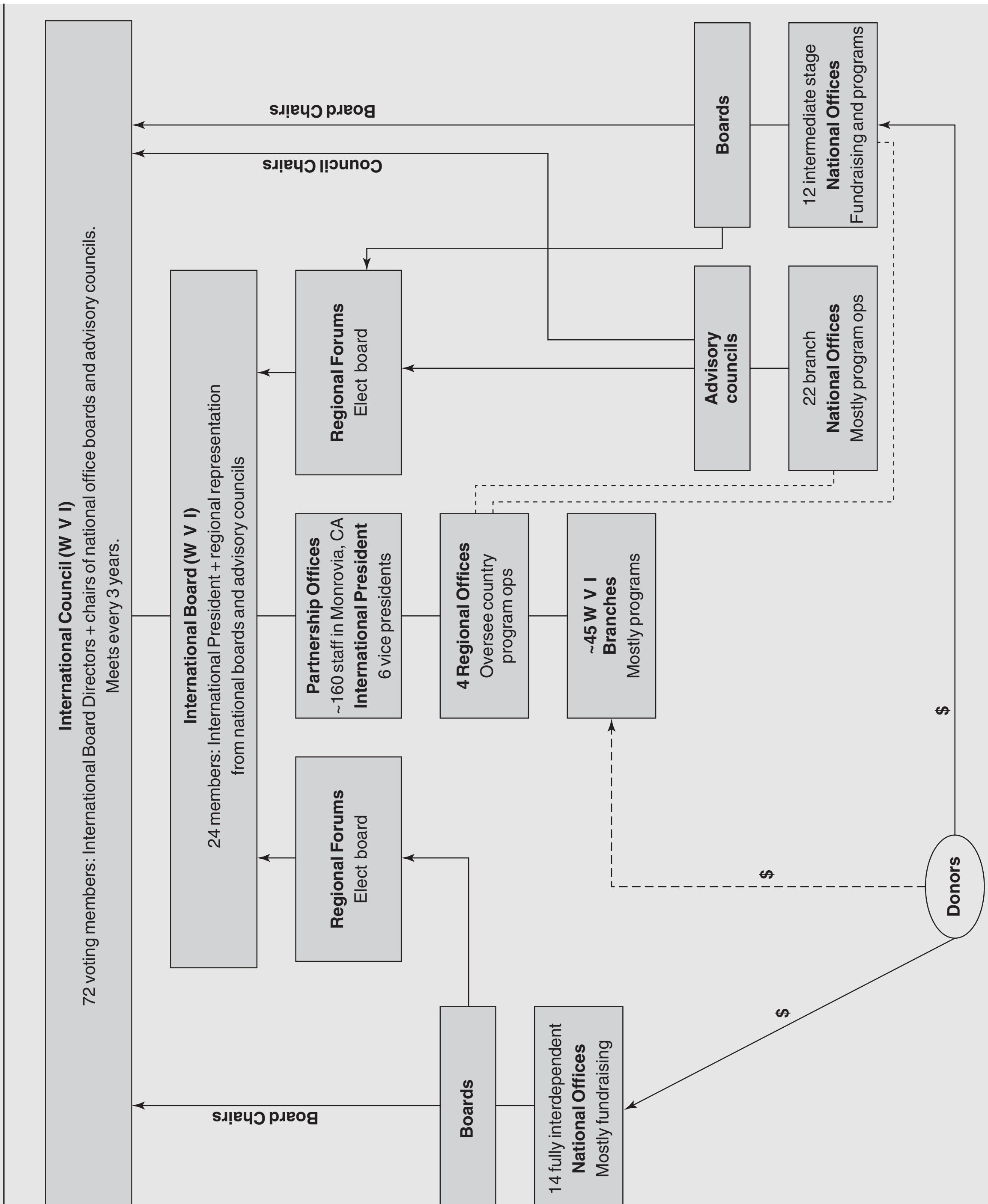
The **partnership office** (previously the international office), located in Monrovia, California, was WVI's executive group. Headed by an international president and four regional and six functional vice presidents, its staff of around 160 supported the day-to-day operations of the partnership. Several other partnership support offices in cities such as Geneva, Los Angeles, and Vienna represented WVI in the international arena through lobbying and advocacy work.

Each of the four **regional offices—**in Costa Rica, Cyprus, Nairobi, and Bangkok—oversaw the program operations of the national offices in its region. These regional offices reported directly to the partnership office.

Most of WVI's 48 **national offices** were either primarily support (fund-raising) offices or field (program-delivery) offices, but a few did both. Each national office had equal direct representation on the international council and also took part in the election of regional representatives to the international board through its regional forum. Local governance and independence from the international office was determined by the national office's stage of development category:

- WVI's 22 branch offices were governed by national advisory committees, but WVI maintained legal responsibility and strong management control over their budgetary and personnel decisions through its regional offices.
- The 12 intermediate-stage offices were governed by local boards composed of business, church, and social service leaders. They voluntarily agreed to seek approval from WVI for critical management decisions such as appointment or termination of a national director or national board member, budget development, and off-budget expenditures.

Exhibit 5 World Vision International Organizational Structure



Source: Casewriter representation.

• The 14 fully interdependent offices were nationally registered nonprofit organizations with their own local boards of directors. Except for certain items specified in the Covenant of Partnership, they did not need WVI approval for decisions. Nonetheless, they were expected voluntarily to coordinate with the partnership office. (Branch and intermediate offices were considered to be in transition toward full interdependence. The process involved peer reviews, WVI consultation, and interaction with the international board.)

By 1996, when Dean Hirsch became the sixth president of WVI, the partnership-based governance model was in place. Hirsch had risen to the top job in WVI following two decades in which he had helped establish World Vision national programs in Rwanda, Zaire, Tanzania, Mali, Ghana, and Malawi then managed major donor marketing for WV-U.S. He described his role in the emerging federated partnership:

> My job is to cast a vision, to make sure that we have alignment between our mission and operations, and to ensure we stay strategic. Because of our dispersed governance, we must operate with trust. The best thing I can do is help to build relationships. So I am the biggest cheerleader in the world . . . but as president of WVI, I also hold a seat on every World Vision board in the world. Either one of my representatives or I attend all meetings. It provides an immediate means of keeping alignment. And I can intervene at any time if one of the partners drifts from our mission or core values.

Fund-Raising in the Partnership: World Vision-U.S.

Within the evolving World Vision global partnership, most national entities were adjusting to the more complex structure within which they had to operate. In the United States, for example, the WV-U.S. Board began to look for a new president to strengthen its fund-raising activity. In June 1998, it offered the job to Richard Stearns, an experienced manager who had spent 23 years in strategic and marketing roles in Gillette Company and Parker Brothers Games and as CEO of Lenox, the well-known tableware and gift company. As WV-U.S. president, Stearns was responsible for all WV-U.S. operations, which included fund-raising, advocacy, and international program development, each run by one of the five senior VPs reporting to him.

Revitalizing WV-U.S.: Marketing, Metrics, and Money Over the years, WV-U.S. had remained the largest financial contributor to the partnership, providing almost 50% of global revenues by 1998. "But the organization was missing opportunities and faltering in its operations," said Stearns. "In particular, our appeals had become costly, and we were inefficient. I was given two key goals: increase revenues and lower overhead ratios." (This ratio was the cash income raised divided by the cost of fund-raising. In 1998, it stood at around 3 to 1.)

In 2000, Stearns hired Atul Tandon as senior VP of marketing. Like Stearns, he had come from the corporate sector, serving for over 20 years with Citibank in marketing. In WV-U.S., Tandon saw his primary objectives to be to build the brand and improve customer satisfaction. "I soon realized that I was in a fundamentally different world," he said. "When I asked, 'What is our bottom line? To whom are we accountable?' no one could answer." Furthermore, staff members were unable to describe their outputs and measures. "There were no profit and loss statements, and people were unaware of our spending and the returns we were getting."

Tandon and Stearns reorganized the WV-U.S. office, laying off a number of staff and elevating innovators to senior positions. They replaced the traditional Direct Response Marketing Department with integrated product and channel marketing teams that worked with new communications and creative teams to focus on the key drivers of marketing effectiveness: cost of donor acquisition, costs and methods of donor retention, and long-term donor value. These new teams focused on growth through partnering, brand building, and new channels of recruiting and retaining donors. While the message to donors had to be altered to incorporate the more community development–based model that the ADP concept supported, they were able to do so under the umbrella of a modified $26 monthly child sponsorship program that was still the most effective means of raising funds for WV-U.S. The marketing team also found that while donors were difficult to recruit, if properly cultivated, they were relatively easy to keep.

Tandon expected marketing teams to be research driven in defining what appealed to donors. They were then required to work with three new channel-specific sales teams to design products specifically for church groups, major donors, and Internet sales. Believing strongly in "learning to listen to the customer," Tandon allocated nearly 75% of the $50 million marketing budget to donor recruitment, retention, and communications. With no increases in marketing and communications allocations over a four-year period, Tandon and his team devoted themselves to increasing revenues while holding expenses flat. "We call it widening the jaws," said Tandon.

The results came quickly: double-digit growth every year for four years with an unchanged marketing budget. "Over those four years, we increased our cash income to fund-raising cost ratio from 3 to 1, first, to 3.4 to 1, then to 4.1 to 1, and finally to 5.5 to 1," Tandon reported. Additionally, donor satisfaction increased, as did name awareness in the core target markets—from 49% to 76% over three years. To evaluate WV-U.S.'s efforts more effectively, Stearns introduced a balanced scorecard measurement system. (See **Exhibit 6** for copy of scorecard.) Tandon volunteered to make his marketing group the guinea pig for the new system, explaining:

> We identified specific numbers-driven goals and a few subjective goals. Most revolved around measuring brand strength, brand awareness, and customer satisfaction. Of these, I believe the most important driver is the customer satisfaction number. Ours is measured twice a year by survey, and we have increased satisfaction levels from 84% to 92% over the last three years. We don't have a good benchmark in the nonprofit world, but in the corporate sector, Amazon's customer satisfaction is the highest at 88%. So we are in the right ballpark.

Managing in the Partnership: All in the Family

In addition to running the operations at WV-U.S., Stearns sat on the Strategy Working Group (SWG), the key executive decision-making body of the World Vision Partnership. Chaired by WVI's president, Hirsch, the SWG included 16 senior executives from throughout the partnership. Coming from the corporate world, Stearns at first found working at WVI difficult. "I was bewildered by the lack of any real authority structure in the partnership," he said. "I kept wondering who was in charge." He also reflected on the governance structure: "The international board is truly representative. The U.S. appoints two of its 24 members and has a founder's chair. The other 21 are from other nations. Representing 50% of overall revenues, we clearly have financial influence, yet we hold only 12% of the formal political control. This would be unthinkable in the corporate world."

Over time, Stearns recognized that the partnership traded control and efficiency for richness of perspective and strength in local programming and fund-raising: "We are able to make our own decisions and set our own priorities. President Hirsch has no line authority over me. He does not participate in my performance review, and he issues no directives to me or any other CEO. But, through the SWG, we make joint decisions that benefit the global organization and our mission better than if any one of us acted alone."

Program Delivery in the Partnership: The AIDS Hope Initiative

By the late 1990s, the World Vision Partnership was beginning to feel more stable. The ADP concept had made program delivery more effective, the child sponsorship fund-raising model had been refined, and the federal organization framework was helping to integrate the global network of World Vision entities. Yet while World Vision had been struggling to refine its internal operations, the impact of HIV/AIDS was changing the needs of those it served externally. The global pandemic had reached crisis levels in many parts of the world, but nowhere more than in sub-Saharan Africa.

Exhibit 6 Balanced Scorecard for WV-U.S. Marketing Department

Marketing & Communications
Level 1 Scorecard

Atul Tandon Reporting Period: Q4 of FY03 (Jul, Aug, Sep)					Quarterly							
					FY03—Q1		FY03—Q2		FY03—Q3		FY03—Q4	
Measure	**Actual**	**Target**	**Variance (%)**	**Variance Flag**	**FY03 Actuals**	**FY02 Actuals**	**FY03 Actuals**	**FY02 Actuals**	**FY03 Actual**	**FY02 Actuals**	**FY03 Actual**	**FY02 Actuals**
CHANGE HEARTS												
1 Media Impressions (in millions)	4,515	2,280	98%	●	625	570	2,717	1,880	3,230	2,815	4,515	3,445
INCREASE INVOLVEMENT												
2 Gross Sponsorship Assignments	144,613	182,941	−21%	■	43,139	44,751	82,473	89,921	116,700	129,514	144,613	169,028
3 Matrix Income ($1,000s)*	$8,797	$6,950	27%	●	$2,923	$3,514	$4,157	$4,507	$6,612	$6,070	$8,797	$6,795
4 Income ($1,000s)*	$229,007	$230,103	0%	◆	$60,054	$56,487	$114,404	$104,455	$171,997	$155,705	$229,161	$208,553
5 Sponsorship File Size	612,815	625,381	−2%	◆	594,216	555,325	601,842	564,575	610,636	574,131	612,815	581,874
6 Donor Involvement—Avg. Annual Giving	$296	$296	0%	●	$278	$271	$285	$276	$277	$276	$296	$280
INCREASE EFFECTIVENESS												
7 Expenses ($1,000s)*	$52,304	$53,975	3%	●	$14,920	$13,460	$28,912	$25,801	$40,453	$37,477	$52,304	$49,431
8 Sponsor Attrition Rate	16.2%	16.5%	2%	●	17.4%	19.5%	17.0%	18.5%	16.4%	17.7%	16.2%	17.4%
9 Donor Satisfaction	90.8%		N/A		N/A	N/A	90.3%	88.7%	N/A	N/A	90.8%	89.4%

Variance Thresholds ● Meets Goal ◆ <5% Adverse ■ >5% Adverse

*** MAC Yield to Ministry (Revenues less Expenses) was better than previous year by $19.5 million (11.7%) and better than budget by $2.4 million**

Metric:	*Definition:*
CHANGE HEARTS	
1 Media Impressions (in millions)	*Number of Christian & Secular Media impressions through publication or broadcast story*
INCREASE INVOLVEMENT	
2 Gross Sponsorship Assignments	*Cum total gross sponsorship acquisitions (all channels except RM)*
3 Matrix Income ($1,000s)	*Income motivated by Marketing & Communications, but booked to other areas—Major Donor + Ethnic Mktg + Corp Partnership*
4 Income ($1,000s)	*Income generated by Marketing & Communications from all sources*
5 Sponsorship File Size	*# of Money Sponsorships Ending last period + Acquisitions—Cancels*
6a Donor Involvement—Avg. Annual Giving	*Rolling 12 mos giving / # donors (cash only for now, GIK to be added later)*
INCREASE EFFECTIVENESS	
7 Expenses ($1,000s)	*YTD Total Marketing & Communications Expenses*
8 Sponsor Attrition Rate	*# of money sponsorships that have not made a payment in the last 6 months/total money sponsorships 6 months prior*
9 Donor Satisfaction	*Donor Satisfaction Rating (Sponsorship Only)*

Source: World Vision International internal documents.

Recognizing the Need: Lessons for a Latecomer Two months after joining World Vision, Stearns went on a field trip to Uganda. Visiting a household of three boys, aged 11 to 13, who lived alone after being orphaned by AIDS, Stearns learned that an estimated 10 million African children were living in similar circumstances. When he asked what World Vision was doing about it, the answer was, "Very little." Although he was new to the agency, he felt he had to speak out:

> When I was at Parker Brothers, we failed to realize that games were moving from the parlor table to the video screen. When new competitors came out with fast and interesting computer games, they stole 90% of the market from under our noses. This was what was happening to us with HIV/AIDS. We had developed top-notch skills at rural community organization, water systems, health, childcare, and economic regeneration and responded well to hurricanes, disasters, wars, and other emergencies. But while all of this was exemplary, we were not prepared to face the unprecedented scale of devastation wrought by the AIDS pandemic.

With 58,000 people in Africa dying from AIDS each week—equal to the entire loss of American lives in Vietnam—Stearns felt there was a real chance that decades of progress by the development community would be rolled back. He began to speak more forcefully, telling his colleagues that they were building beautiful sand castles on the beach while an 80-foot-high tidal wave was just offshore. "I kept saying it for over two years, fully mindful that I did not know what specifically I was proposing to do about it," he recounted. He was supported by Bruce Wilkinson, senior vice president of his International Programs Group. But while other members of the partnership listened, Stearns felt that, on their overloaded agenda, it was "just another woe to add to the list."

Then, in July 2000, Wilfred Mlay, African regional vice president, gave a powerful presentation to the SWG. "AIDS is killing our people," he said. "It is devastating our work, our families, our staff. I really need your help." A few months later, when *Time* ran a cover story on the 10 million to 12 million children in Africa estimated to be orphaned by AIDS, Stearns circulated a memo to senior executives of the partnership asking, "Why, as a child-focused organization, are we not addressing the AIDS crisis?"

Mlay's appeal and Stearns's prodding prompted the SWG to appoint Myers, vice president for International Programs Strategy, to study WVI's commitment to the crisis. After speaking with a number of people throughout the partnership, he wrote a draft document suggesting that HIV/AIDS needed to be a priority for World Vision for five reasons: it cared about children, including the 40 million projected to lose one or both parents to HIV/AIDS by 2010; it had over 900,000 sponsored children in the 30 worst-hit countries and nearly 2 million sponsored children at risk worldwide; it was investing almost $200 million a year in the 30 worst-hit countries; its worldwide staff was at risk, and many were personally affected by HIV/AIDS in their own extended families; and as a Christian organization, it had an opportunity to bring its mission to those affected by HIV/AIDS.

Launching the AIDS Hope Initiative On World AIDS Day in December 2000, Hirsch preempted any formal decision on an HIV/AIDS strategy by announcing that World Vision would launch a $30 million initiative to address the crisis. Believing that the moment was right and that some members were already moving forward, Hirsch pushed the partnership into action. Over the following months, Myers prepared a plan entitled "The HIV/AIDS Hope Initiative," outlining the need and identifying the scope of the problem. The plan also categorized a series of programming approaches for high-prevalence countries, medium-prevalence countries, and the rest of World Vision's country programs.

Just before presenting the plan to the SWG at a meeting in Costa Rica in February 2001, Hirsch approached Casey and asked him if he would lead the AIDS initiative. "I was surprised by the request," recalled Casey. "It was an entirely new and different task for me. I had spent six years as a senior line manager in operations for the U.S. organization. Now I would be taking on a key strategic role within WVI's partnership office." For most of his eight years with WV-U.S., Casey had served as senior vice president for fund-raising and programs. But, in 1999, Stearns's reorganization had left him a senior executive without a portfolio. "For about a year, I worked on special projects within the senior management team. They were rewarding, but I was considering moving on," Casey said.

As he thought about it, Casey decided that this new project represented an interesting and worthwhile challenge. In March 2001, he assumed his new role as director of the HIV/AIDS Hope Initiative. He would report directly to Hirsch but continue to work out of the WV-U.S. office in Seattle.

Assessing the Challenge Casey returned to Seattle with an approved operating budget of approximately $750,000 but no staff. As he reviewed the existing document, he recognized the difficulty of his task:

> I began working off of the document that Bryant [Myers] had prepared. Although it was good work, it had been devised almost entirely at the headquarters office. Essentially, I was being asked to implement an unprecedented worldwide program effort on perhaps the most controversial issue imaginable that would require new levels of coordination that we had never previously achieved. Yet there was no ownership or buy-in from the regional VPs.

Casey understood that, within the partnership, the four regional VPs (for Africa, Asia, Pacific, and Middle East/Eastern Europe) held a great deal of power over programs and operations due to the fact that all the national directors reported to them. In recent years, however, the national offices had been pushed by the international board to become more independent in their strategies and programs. Casey stated: "In our efforts to devolve autonomy to the national offices, we had worked for 10 years to develop viable governing boards for each one. But we also wanted them to be responsive to WVI's global priorities through their link to the regional VPs. Because national directors were answerable to two masters, this could cause problems."

To build support for the Hope Initiative, Casey began a six-month process of travel and discussion with the regional VPs and national directors. He wanted to make sure that the initiative would remain true to its ideal while also ensuring that the ambitious fund-raising and programmatic objectives were realistic from the field's perspective.

Resistance from Donors Casey knew that funding such a big initiative would be a challenge and hoped to implement a joint marketing effort across the partnership offices, hopefully reaching out to new donors in the process. He also wanted the marketing effort to be well connected to the programs in the field. But almost from the outset, he encountered resistance from the marketing departments in the major partnership support offices. Stearns remembered:

> Our WV-U.S. marketing people were very skeptical. They told us that any work with HIV/AIDS would never sell with our donors. Our top people in brand building told us that we have a very wholesome child-focused image. People equate us helping children and families in need. They said that if we start talking about AIDS, prostitutes, drug users, long-haul truckers, and sexuality, it would hurt our image.

WV-U.S. commissioned a market survey among evangelical Christians and loyal donors in the United States. "It was devastating news," stated Casey. "We asked them if they would be willing to give to a respectable Christian organization to help children who lost both parents to AIDS. Only 7% said that they would definitely help, while over 50% said probably not or definitely not. Surveys in Canada and Australia found the same thing. It was stark and clear that our donors felt that AIDS sufferers somehow deserved their fate."

Beyond donor reaction, Casey dug deeper to understand the marketing organization's challenge. "Their incentives and targets for the year were based on the efficiency of their appeals," he said. "But by its very nature, this was going to be a costly appeal." Instead of returning a usual 4 or 5:1 ratio of revenues to expenses, the marketers felt that, in the beginning at least, any AIDS appeal would return something closer to 1:1. So when Casey asked the heads of the partnership offices to adjust the targets for HIV/AIDS programs for their marketing teams, the response was mixed. While Stearns convinced his board to remove the HIV/AIDS appeals from the normal cost-ratio calculations for U.S. appeal, Canada, the United Kingdom, and several other key fund-raising countries were less willing to do so.

Resistance from the Field As he focused on program implications, Casey had Mlay as a natural ally. As regional vice president for Africa, Mlay reported to Hirsch at WVI and was responsible for 25 national country offices with over 8,000 staff (mostly field and program officers, but also technical specialists in areas such as microenterprise, health, child protection, and Christian ministry) and a budget of $500 million. To manage his domain, Mlay had divided Africa into three subregions, each headed by a director (based in Johannesburg, Dakar, and Nairobi) responsible for eight or nine countries. "I have structured the African region differently from any of the other regions," he said. "For example, in Asia, all the senior leaders share one office in Bangkok. But because it is difficult to travel and communicate, my senior leadership and technical teams are dispersed. And I want them to be where the action is happening."

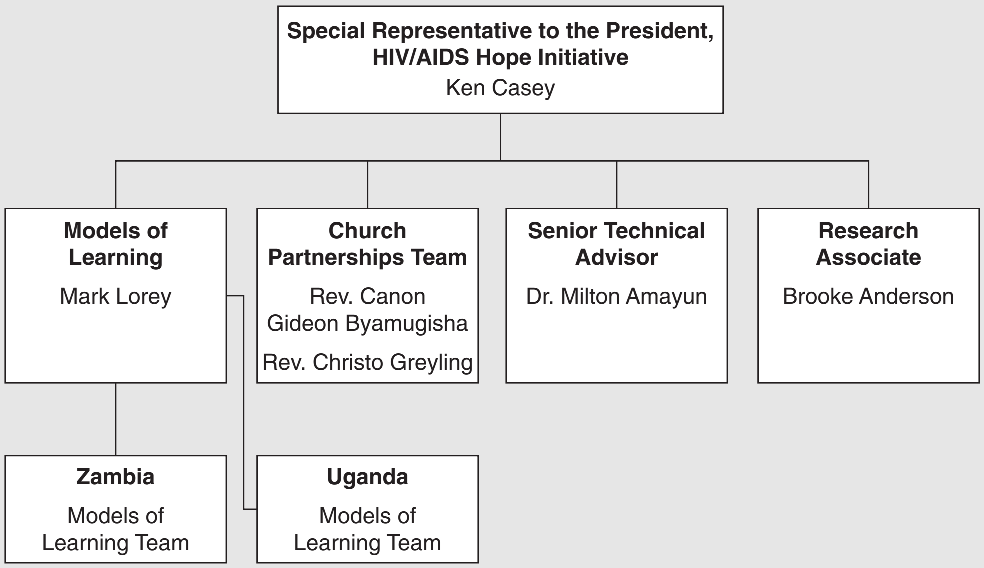
Although he managed the African region as he saw fit, Mlay could also use services in the partnership: "I am in charge but have access to resources when needed. For example, we have some sophisticated protocols for emergency operations. If I put out the call for help, we will have a conference call within five hours. And I have access to a global rapid-response team that can allocate $1 million within 72 hours, so I can promise that WV will be present at a crisis within 24 hours."

Mlay worked with the boards and advisory councils in his 26 national offices to implement WVI priorities. But while he held regular meetings with national directors and hosted conferences and forums to determine how to allocate his technical resources, he had only limited ability to determine the strategy of national programs. "The advisory councils and boards help us to connect to the local community and society," he said. "But I have a reserved seat on every board in Africa, so World Vision management and local boards share the governance of our work." Managing the boards was a time-consuming task for Mlay, who sometimes had to act if a board went in a direction that WVI disapproved of: "For example, we discovered that the head of one of our boards had a set of values that conflicted with those of the organization. We intervened and asked him to step down. Most of the board was against us, but we prevailed. There is a fine line between granting autonomy and maintaining standards."

Despite his ability to intervene when necessary, Mlay had long encouraged his national directors to determine their own goals and strategies through the ADP system. Indeed, under the federated partnership structure, they could even have direct contact with any of the support offices to fund their ADP projects. But now that he wanted to push HIV/AIDS programs, he faced resistance. "There is a culture of silence around the issue," he said. "In Tanzania, entire families and villages are being wiped out by AIDS. We have grandmothers caring for 10 and 12 children. The ADPs are strong, but people are ashamed to speak about it. This is especially true of church leaders, who refuse to see this as their problem. Many even talk about AIDS as God's punishment of sinners."

Casey also reflected on the "phenomenon of denial" he encountered. On an early trip to Capetown, he spoke to a taxi driver who told him that his awareness of HIV/AIDS had not changed his lifestyle because it would not get him. "A few minutes later, he was describing how the trucking company for whom his sister worked had just adopted a new HR policy stating that employees could not attend more than three funerals per month," recalled Casey. "It was uncanny how he could hold both thoughts in his head and not make a connection. In the face of such clear evidence, even intelligent people did not want to recognize the crisis."

Exhibit 7 Hope Initiative 2001 Organizational Structure



Source: World Vision International internal document.

Casey described the response to his first six months in the field: "Program officers were working flat out on existing projects and we came in telling them that, while those are important, we want you to change your whole focus. In addition, most program officers were skilled in technical sectors such as water, education, and economic development. Few knew about HIV/AIDS work. Their practical response was, 'It's not our expertise. What can we really do about AIDS?'"

Casey hired two teams of HIV/AIDS specialists, one in Uganda and one in Zambia, to create a "Models of Learning" program. He also hired a research associate to work out of the international office (see **Exhibit 7**). Hoping to build an active learning tool for the rest of the field, they prepared models of programming that they hoped to make available to others. But early response from a number of national offices was muted. "In the face of the overwhelming need and workload, many felt that this was just the emphasis of the day. Wait it out and it would go away," Casey explained. After all, it was not the first time that field offices had been asked to implement cross-organizational strategies, as Myers recalled:

> In the mid-1990s, we embarked on a long and expensive process of rebranding. Many national offices plunged time and resources into the effort but got little value out of it. And a subsequent initiative to move relief activities from the center out into the national offices ran into difficulty trying to mix the cowboy culture of the relief teams with the slower culture of the development teams on the front lines. Not surprisingly, some national offices are wary of any new top-down initiative—particularly now that they have so much independence.

The South African Conference

In December of 2001, Casey released a first draft of the Hope Initiative matrix (see **Exhibit 8** for a later version), which had been developed over months of dialogue and meetings with key personnel from across the partnership. It laid out the goals, beneficiaries, values, and key design principles for each of the three HIV/AIDS program areas: prevention,

Exhibit 8 HIV/AIDS Hope Initiative Program Matrix

Overall Goal	*The overall goal of the HIV/AIDS Hope Initiative is to reduce the global impact of HIV/AIDS through the enhancement and expansion of the World Vision programs and collaborations focused on HIV/AIDS prevention, care and advocacy.*		
	Prevention	**Care**	**Advocacy**
Track Goals	Make a significant contribution to the reduction of national HIV/AIDS prevalence rates	Achieve measurable improvements in the quality of life of children affected by HIV/AIDS	Encourage the adoption of policy and programs that minimize the spread of HIV/AIDS and maximize care for those living with or affected by HIV/AIDS
Target Groups	• Children, aged 5–15 years old • High-risk population groups • Pregnant and lactating mothers	Vulnerable Children (living with, affected by and orphaned by HIV/AIDS, including parents and caregivers of vulnerable children)	Policymakers (local, national, and international)
Values	Bring a Christian response to HIV/AIDS, one that reflects God's unconditional, compassionate love for all people and affirms each individual's dignity and worth.		
Key Program Design Principles	• Clear and measurable impact indicators • Integrated with key agencies and organizations in the country • Multisectoral in approach • Scalable—the ability to impact a large number of people • Empower, engage, and equip the local church as a primary partner, as well as other faith-based organizations • Integrated with WV national office program strategies		

Source: World Vision International internal documents.

care, and advocacy. An accompanying document outlined actions that would seek to meet several goals. First, it would aim to prevent new cases of HIV/AIDS by contributing to the reduction of national incidence rates, especially among children, high-risk groups, and pregnant and lactating mothers. Second, it would aim to provide measurable improvements in the quality of care for children affected by HIV/AIDS, including those orphaned by AIDS, living with HIV-positive parents, and in households fostering AIDS orphans. Finally, it would advocate the adoption of public policy and programs that would minimize the spread of the disease and provide care for those living with or affected by HIV/AIDS.

On January 12, 2002, the real rollout for the Hope Initiative was about to begin at a weeklong high-prevalence country workshop held at a safari lodge in South Africa. Casey's goal was to bring together the national directors, senior program officers, and area development managers from the 17 African countries hardest hit by the crisis. He planned to ask them to tackle the HIV/AIDS problem with the same energy with which they worked to bring communities clean water, education, health care, food security, and economic development. "It was a make-or-break time for the initiative," said Casey. "Without their energy and buy-in, the initiative would only exist on paper."

Reading 4-1 Making Global Strategies Work

W. Chan Kim
Renée A. Mauborgne

It is hardly a novel insight that global competitive forces compel multinationals to fully leverage the distinctive resources, knowledge, and expertise residing in their subsidiary operations. Questions of what are "winning" global strategic moves for the modern multinational have increasingly intoxicated international executives.[1] Yet for all the fanfare about global strategies and their increasingly undeniable link to multinational success, little has been said or written about how to make global strategies work. The key question we address here is just that: What does it take for multinationals to successfully execute global strategies?

Our research results paint a striking picture of the importance of the strategy-making process itself for effective global strategy execution. Over the last four years, we have done extensive research to understand how multinationals can successfully implement global strategies. Because subsidiary top managers are the key catalysts for, or obstacles preventing, global strategy execution, we asked them directly just what it was that motivated them to execute or to defy their companies' global strategic decisions.

Subsidiary top managers were quick to rattle off a series of well-established implementation mechanisms: incentive compensation, monitoring systems, and rewards and punishments. They were equally quick to add that they did not believe these control mechanisms alone to be either sufficient or that effective. The general consensus was that these mechanisms were not particularly motivating and were easy to dodge and cheat. Even more recurrent in our discussions, however, were the dynamics of the global strategic decision-making process itself. When deciding whether or to what extent to carry out global strategies, subsidiary top managers accorded great importance to the way in which those strategies were generated. Their overriding concern involved a deceptively simple though evidently profound principle: due process should be exercised in the global strategic decision-making process.

In practical terms, due process means: (1) that the head office is familiar with subsidiaries' local situations; (2) that two-way communication exists in the global strategy-making process; (3) that the head office is relatively consistent in making decisions across subsidiary units; (4) that subsidiary units can legitimately challenge the head office's strategic views and decisions; and (5) that subsidiary units receive an explanation for final strategic decisions.

In short, we observed that, in the absence of these factors, subsidiary top managers were often upset and negatively disposed toward resulting strategic decisions. However, in the presence of these factors, the reaction was just the reverse. Subsidiary top managers were favorably disposed toward resulting decisions, thought them wise, and were motivated to implement them even if, and here is the biggest benefit of all, these decisions were not in line with their individual subsidiary units' interests.

We begin this paper by probing in depth just what subsidiary top managers mean by due process and why they judge its exercise important in the

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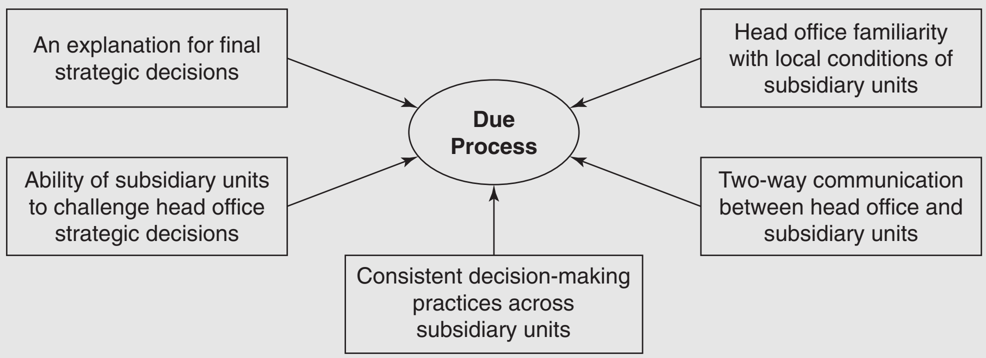
[1]For an excellent review of the literature on global strategy, see: S. Ghoshal, "Global Strategy: An Organizing Framework," *Strategic Management Journal* 8 (1987): 425–440.

Figure 1 What Is Due Process in Global Strategic Decision Making?



global strategy-making process. Next we examine what leads subsidiary top managers to view traditional implementation mechanisms as increasingly insufficient for global strategies. Finally, we trace the real effects of due process in global strategy making on global strategy execution and explore why they are so profound.

The Meaning of Due Process

To get to the heart of how multinationals can make global strategies work, we held extensive interviews with sixty-three subsidiary presidents.[2] Our initial objective was to get subsidiary presidents' honest evaluation of the factors that drove them to carry out or resist their organizations' global strategic decisions. As the interviews progressed, the one tendency that stood out was the subsidiary presidents' natural inclination to discuss how global strategies were generated. Time and again, the dynamics of the global strategy-making process itself were the centerpiece of their discussions. Their principal concern was whether due process was exercised. That is, was the strategy-making process fair from the subsidiary unit perspective?

Through these interviews, we identified the five characteristics above that, taken together, defined due process in global strategic decision making (see Figure 1).[3] What is interesting is that these five characteristics were important regardless of the industry or the subsidiary's strategic importance. Appendix A profiles our sixty-three subsidiary presidents and discusses how they were selected. Here we discuss each of the characteristics and examine through the eyes of subsidiary top managers what makes each of them vital.

Head Office's Familiarity with Local Conditions

> The head office does not know a damn thing about what's going on down here. They tell me to further push their global "core" products even at the expense of our existing product lines. And you know what I

[2]For an extensive discussion on our field study, see: W.C. Kim and R.A. Mauborgne, "Implementing Global Strategies: The Role of Procedural Justice," *Strategic Management Journal* 12 (1991): 125–143; and W.C. Kim and R.A. Mauborgne, "Procedural Justice Theory and the Multinational Organization," in *Organization Theory and the Multinational Corporation,* eds. S. Ghoshal and E. Westney (London: MacMillan, 1993).

[3]The Q-sort technique was used to define the meaning of due process in global strategic decision making. For a detailed explanation of this process, see: Kim and Mauborgne (1991 and 1993a).

> tell them? I tell them they're crazy. They don't realize that not only don't these "core" products sell in our local market but that we are already losing sales on our existing product lines from tough local competitors due to our lack of push on them.

This statement indicates subsidiary top managers' attitudes when the head office lacks knowledge of the local market. One manager explains why local familiarity is important:

> The head office needs to invest in understanding the local market. How can I respect their decisions and follow them if I don't believe that they are made with an understanding of the local market?

When subsidiary managers believe the head office has a reasonable grasp of the local situation, they are apt to make statements like this one:

> I have tremendous faith and trust in the head office's strategic decisions. They know the local market. When they make a decision, they understand the ramifications of that decision, be those ramifications good or bad. Whether I like their decisions or not, there's at least a method to their madness.

What it comes down to is that in the absence of local familiarity, subsidiary top managers do not judge the head office to be competent and sincere. They tend to think of the head office instead as incapable and apathetic toward their foreign operation. As a consequence, these managers have little respect for the decisions coming down. They quickly become skeptical of the soundness and quality of the resulting global strategies. This provides an excellent excuse for not only why they do not implement global strategies but why they should not. As one executive put it, "To not follow the global strategic decisions handed down to a subsidiary unit is not a curse but a blessing in disguise. Those decisions aren't based on reality; they are based on air." At the most, local familiarity gives confidence that global strategies are based on thoughtful analyses; at the least, it prevents subsidiary managers from using this seemingly reasonable justification for not executing global strategic decisions.

Two-Way Communication When global strategic decisions are being made that affect a subsidiary unit, subsidiary top managers value the ability to voice their opinion and work back and forth with the head office in decision formulation. This communication symbolizes the respect the head office has for subsidiary units as well as the confidence it places in subsidiary managers' opinions and insights.

Our observation is that this respect and confidence is quickly reciprocated by subsidiary top managers as well. Although two-way communication often results in heated debates, it also builds a profound spirit of comradeship, unity, and mutual trust among the head office and subsidiary top management teams. Moreover, when subsidiary managers participate in global strategic decision making, they come to view the decisions as their own. As a result, they often defend and uphold these decisions. As one executive commented:

> The open exchange of information and ideas is critical in global strategy making. It opens the ears of managers in both the head office and subsidiary units and typically results in better value judgments. When we [subsidiary managers] feel that our views are given sufficient attention, we are less likely to be dissatisfied with global strategic decisions or to feel antagonistic toward the head office and are better motivated to act rigorously to carry out the agreed-upon plan of action.

Consistent Decision-Making Practices Consider two opposing comments made by different executives. One says:

> Our global strategic decision making is a very political process. If you are on the "inside track," the head office treats you as a relatively important element of global strategic decision making. But if not, you and your unit are likely to be completely overlooked and just slapped with a set of strategic decisions that are supposed to be implemented. At times, I think the whole process is just a scam, a politicians' arena where strategic decisions reflect not competitive and economic dynamics but the dynamics of political interplay.

The other says:

> Admittedly subsidiary units don't walk away with symmetric decision outcomes—one subsidiary unit may get what seems to be a windfall allocation of resources while another may take a cut. But all subsidiary units are treated relatively consistently when it comes to how these decisions are reached. It's a fair process. There doesn't seem to be much favoritism or political jockeying in this decision-making process.

These two comments shed light on why consistent decision-making practices across subsidiary units are a prized aspect of due process. Basically, they are thought to minimize the degree of politics and favoritism in the strategy generation process. Subsidiary managers are confident that there is a level playing field across subsidiary units. And this is important. Subsidiary managers do not expect the strategic decisions made across subsidiary units to be identical, as they understand that units are not equally important for the organization. But they do view the consistent application of decision-making rules as an essential element of due process.

In the absence of consistency, subsidiary managers are quick to judge the decision-making process as arbitrary, politically rigged, and hence not to be trusted. They find the confusion and uncertainty extremely frustrating, and they are inclined to attribute unfavorable strategic decisions to unfair decision rules as opposed to competitive and economic dynamics. Consequently, they become bitter and resentful and more apt to want to undermine resulting decisions.

Ability to Refute Decisions Having the ability to refute the head office's strategic views and decisions also makes subsidiary managers feel that due process is being exercised. Admittedly this can be traced in part to managers' perceived increase in influence over strategic decisions, but our discussions suggest another reason why the ability to refute is important. It makes managers feel that the process is fair simply because they can clearly point out possible misperceptions or wrong assumptions made by head office managers concerning local conditions or subsidiary operations. But more than this, the ability to challenge head office decisions inspires subsidiary managers to more willingly follow these decisions because they know that if the decisions should prove unreasonable or wrong-headed, the possibility always exists to correct them. As one executive explained:

> When I know I have the right to openly challenge the head office's decisions, that automatically tells me that the head office is confident in their decisions, that they have faith that their underlying logic and analyses can stand the test of open scrutiny. But it also tells me that, despite the head office's confidence, they also recognize that being removed from the local market opens up the possibility that they will judge the local situation incorrectly. Not only do I respect the head office for this, but it in turn gives me confidence that the intentions and global strategic decisions of the head office are truly made in the interests of the overall organization and not based on politics.

An Explanation for Final Decisions Subsidiary top managers think it only fair that the head office give them an explanation for final global strategic decisions. And they consider it an important aspect of due process. In short, subsidiary managers need an intellectual understanding of the rationale driving ultimate decisions. They want to know why they should carry out the decisions. This is especially true if those decisions override their expressed views or seem unfavorable to their own unit. To quote one executive:

> When the head office provides an explanation for why decisions are made as they are, they provide evidence that they acted in a fair and impartial manner. This signals to me that the head office has at least considered the subsidiary point of view before they may have rejected it. When I understand why final strategic decisions are made as they are, I'm more inclined to implement those decisions even if I don't particularly view them as favorable.

What Makes Due Process Important for Global Strategy Execution

As our interviews with subsidiary presidents progressed and the meaning of due process became clear, a second equally important trend became visible: those managers who believed that due process was exercised in the firms' global strategy-making process were the same executives who trusted their head offices significantly, who were highly committed to their organizations, who felt a sense of comradeship or unity with the corporate center, and who were motivated to execute not only the letter but also the spirit of the decisions. That is, not only did subsidiary presidents articulate the importance of due process in global strategy making, but their attitudes and behavior were significantly affected by its perceived presence or absence. And not just any attitudes or behavior, but attitudes and behavior that determine the success or failure of global strategy execution.

A review of some of the most popular global strategic prescriptions makes this point clear. They are as follows: locate each value-added activity in the country that has the least cost for the factor that activity uses most intensely;[4] dexterously shift capital and resources across national markets, cross-subsidizing global units, to knock out global competitors;[5] institutionalize fully standardized product offerings, marketing approaches, and commonly used distribution systems worldwide to allow for maximum global efficiencies;[6] and, as argued recently, consciously consolidate worldwide knowledge, technology, marketing, and production skills to build reservoirs of distinctive core competencies that can act as engines for continuous new business development, innovation, and enhanced customer value.[7]

[4]B. Kogut, "Designing Global Strategies: Comparative and Competitive Value-Added Chains," *Sloan Management Review,* Summer 1985, pp. 15–28; and M.E. Porter, "Competition in Global Industries: A Conceptual Framework," in *Competition in Global Industries,* ed. M.E. Porter (Boston: Harvard Business School Press, 1986).
[5]G. Hamel and C.K. Prahalad, "Do You Really Have a Global Strategy?" *Harvard Business Review,* July–August 1985, pp. 139–148; and W.C. Kim and R.A. Mauborgne, "Becoming an Effective Global Competitor," *The Journal of Business Strategy,* January–February 1988, pp. 33–37.
[6]T. Levitt, "The Globalization of Markets," *Harvard Business Review,* May–June 1983, pp. 92–102; and G.S. Yip, "Global Strategy . . . In a World of Nations?" *Sloan Management Review,* Fall 1989, pp. 29–41.
[7]C.K. Prahalad and G. Hamel, "The Core Competence of the Corporation," *Harvard Business Review,* May–June 1990, pp. 79–91.

Each of these global strategic prescriptions is different. There is no one formula for success. Different global competitive and economic dynamics will always dictate different and multiple routes to success. Yet a fundamental thread runs through and unites each of these prescriptions, and that is the underlying condition necessary for the effective execution of each strategy.

Ask about any of these purported global strategies: What does it take to successfully execute it? Time and again the answer involves three underlying requirements: (1) the increasing sacrifice of subsystem for system priorities and considerations; (2) swift actions in a globally coordinated manner; and (3) effective and efficient exchange relations among the nodes of the multinational's global network. Which is to say that to implement global strategies, multinationals need subsidiary managers with a sense of commitment, trust, and social harmony. Organizational commitment inspires these managers to identify with the multinational's global objectives and to exert effort, accept responsibility, and exercise initiative on behalf of the overall organization—despite potential "costs" at the subsidiary unit level. Trust is essential to work out mutual wills in the multinational. It inspires subsidiary managers to more readily accept in good faith the intentions, actions, and decisions of the head office instead of second guessing, procrastinating, and opportunistically haggling over each directive. Which is to say that trust is necessary for quick and coordinated global actions. Lastly, social harmony is essential to strengthen the social fabric among members of global units. It encourages efficient and effective exchange relations, which have fast become indispensable to effective global strategy execution.

These salutary attitudes, however, are not in and of themselves sufficient to make global strategies work. Beyond this, multinationals need to ensure that subsidiary managers actually engage in not only compulsory but also voluntary execution of strategic decisions. By compulsory execution, we mean carrying out the directives of global strategic decisions in accordance with the multinational's formally required standards—satisfying, to the letter, the stipulated responsibilities. In contrast, by voluntary execution, we mean exerting effort beyond that which is formally required to execute decisions to the best of one's abilities. Put differently, it is the effort subsidiary top managers exert beyond the call of duty to implement global strategic decisions.[8]

What all this suggests is that the exercise of due process in global strategic decision making represents a potentially powerful though unexplored route to the implementation of global strategies. Not only do subsidiary top managers emphasize the importance of fairness and impartiality in global strategic decision making, they are so obsessed by the existence or nonexistence of due process that it profoundly affects their attitudes and behavior—attitudes and behavior that are virtually indispensable to making global strategies work. We are talking about commitment, trust, social harmony, and the motivation to execute not only the letter but also the spirit of decisions—that is, to engage in compulsory and voluntary execution of strategic decisions.

But what about other implementation mechanisms? Are traditional implementation mechanisms alone not sufficient for the effective execution of global strategies? If not, how does due process support these traditional mechanisms to make global strategies work?

Traditional Implementation Mechanisms

As mentioned earlier, when we asked subsidiary presidents what motivated them to implement or to defy global strategic decisions, they typically began with a list of well-established administrative mechanisms. Most of them mentioned incentive compensation, monitoring systems, the fist of the head office, and the magnitude and precision of rewards and punishments. But as our discussions progressed, we found subsidiary presidents eager to add that they did not believe these implementation tools alone to be either sufficient or effective. For one thing, they were not particularly motivating. For another, the tools were increasingly easy to dodge and cheat.

Not Motivating?

> I am not saying that rewards and punishments and auditing systems are useless in the implementation process. They certainly are useful. If the head office could assess exactly to what extent I followed global strategic decisions and rewarded me based precisely on that behavior, it would be a lie to say that this would not act as an incentive to execute global strategies. It would. It's just that this would not motivate me to do more than is absolutely necessary to satisfy the minimum requirements of global strategic decisions. It wouldn't inspire me to exert energy, exercise initiative, or to take on tasks that I am not directly compensated for in the execution of global strategies.

This comment, made by one executive, is representative of the general opinion of most of the subsidiary presidents we interviewed. Save for a few specific cases, we discovered that a reliance on instrumental approaches produced a utilitarian, contractual attitude toward compliance.[9] Stated succinctly: to the extent that subsidiary top managers judge that the head office can carefully monitor their behavior and will accurately allocate rewards and punishments, managers have an incentive to satisfy the minimum requirements of global strategic decisions. No more, no less. Instrumental approaches have the power to encourage only compulsory execution—execution to the letter, not to the spirit, of the decisions. The trouble, as we have already argued, is that to make global strategies work, subsidiary managers cannot simply "execute

[8]For an extensive discussion of these two forms of compliance, both the conceptual distinction between them and their theoretical root, see: C. O'Reilly and J. Chatman, "Organizational Commitment and Psychological Attachment: The Effects of Compliance, Identification, and Internalization on Prosocial Behavior," *Journal of Applied Psychology* 71 (1986): 492–499; and P.M. Blau and W.R. Scott, *Formal Organizations* (San Francisco, California: Chandler Publishing Company, 1962), pp. 140–141.

[9]That a reliance on instrumental approaches to compliance leads to utilitarian contractual attitude toward involvement relations finds strong support in the award-winning article: J. Kerr and J.W. Slocum, "Managing Corporate Culture through Reward Systems," *Academy of Management Executive* 1 (1987), 99–108.

this" or "undertake that" in some highly prescribed manner. Their actions must be secured less by rational calculations of individual gain than by kinship obligations. What we are talking about is voluntary execution. An example will bring this to life.

The Case of Global Learning Global learning—the ability of a multinational to transfer the knowledge and expertise developed in each part of its global network to all other parts worldwide—has fast become an essential strategic asset.[10] For global learning to be actualized, we argue that nothing less than an affirmative attitude toward cooperation will suffice—that is, voluntary execution. One reason for this is that knowledge and expertise are often viewed as power and as such are not easily shared. Another reason is that the major benefits of internal diffusion of know-how accrue to recipients, not transmitters. Of course, were it possible for subsidiary units to "sell" their knowledge and expertise to other subsidiary units, these problems might be overcome. However, this is often and perhaps usually infeasible. As know-how is largely an intangible asset, its value to a "purchasing" unit cannot be known until the purchaser has it, but once the knowledge is disclosed, the purchaser has acquired it without cost.[11] In the absence of economic incentives and with the presence of perceived power disincentives to diffuse knowledge and expertise, it follows that full-blown global learning will not transpire as long as quid pro quo attitudes toward strategy execution prevail. Rather, the hoarding and withholding of knowledge and expertise are far more likely.

Easy to Dodge and Cheat? Beyond the fact that subsidiary managers do not consider these instrumental approaches to be that motivating is the reality that managers increasingly find these tools easy to dodge and cheat. And if they are easy to dodge and cheat, they are truly ineffective. Basically, the decline in their effectiveness can be explained by the collapse of the three distinctive features of hierarchy in the modern multinational. These three features are: (1) appraisal and control capability; (2) the power of the head office; and (3) common values and expectations.[12] Traditional implementation tools are increasingly easy to dodge as these hierarchical features collapse.[13] Let us take a quick look at the forces leading to the demise of these features.

Collapse of Appraisal and Control Capability International executives are witnessing a collapse in the multinationals' appraisal and control capability. Although, in theory, information systems can be designed to meet the complexity of any organization or situation, in reality, they are having a tough time meeting the modern multinational's demands. The predominant reason for this is the rapid increase in horizontal linkages and interdependencies across subsidiary units. As subsidiary units increasingly share resources and work together on single projects to realize global economies of scale and scope, the unique performance and contribution of each subsidiary unit is increasingly difficult to decipher.[14] Distinctions between faulty and meritorious performance are becoming tenuous. Confusion opens the door for shirking, opportunistic behavior and conflict. Moreover, this problem is made even more severe by the escalating size of most multinationals. The corporate center is limited in its ability to make accurate evaluations of each subsidiary unit.

Eroding Power of the Head Office No longer do centrally directed orders elicit easy obedience from

[10] C.A. Bartlett and S. Ghoshal, "Managing across Borders: New Strategic Requirements," *Sloan Management Review,* Summer 1987, pp. 7–16; and S. Ghoshal and C.A. Bartlett, "Creation, Adoption, and Diffusion of Innovations by Subsidiaries of Multinational Corporations," *Journal of International Business Studies,* Fall 1988, pp. 365–388.

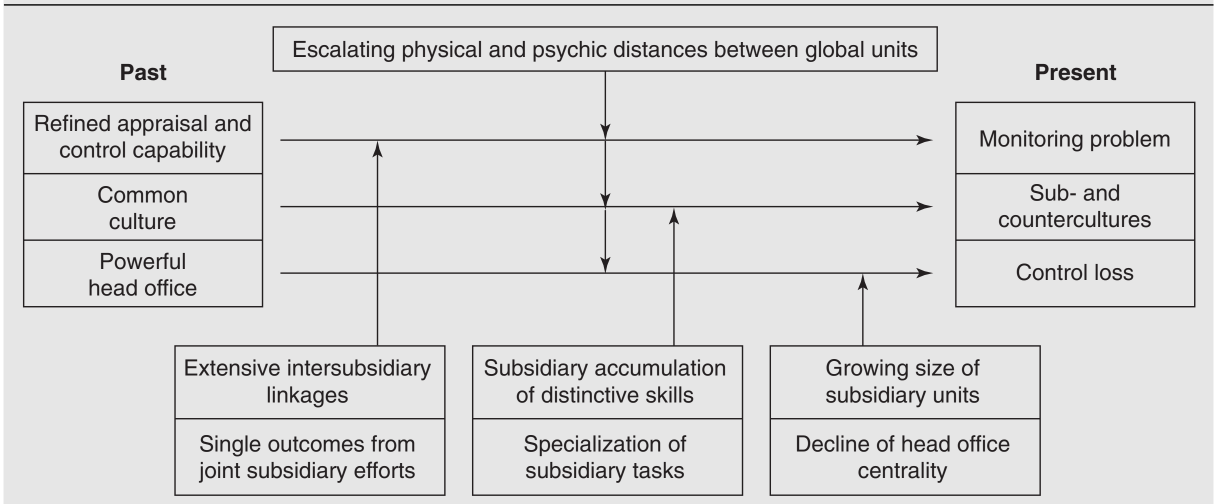
[11] K.J. Arrow, "The Organization of Economic Activity," *The Analysis and Evaluation of Public Expenditure: The PPB System* (Joint Economic Committee, Ninety-first Congress, First Session, 1969), pp. 59–73.

[12] For a brilliant discussion on the distinctive powers of hierarchy and internal organization, see: O.E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (New York: Free Press, 1975).

[13] See the perspicacious article by Hedlund for further support for this argument: G. Hedlund, "The Hypermodern MNC-A Heterarchy?" *Human Resource Management* 25 (1986), pp. 9–25.

[14] For an extensive discussion on the ways in which interdependencies and joint efforts confound accountability and create monitoring difficulties, see: G.R. Jones and C.W.L. Hill, "Transaction Cost Analysis of Strategy-Structure Choice," *Strategic Management Journal* 9 (1988), pp. 159–172.

Figure 2 The Collapse of Hierarchy in the Modern Multinational Corporation



subsidiary units. One reason for the erosion in the head office's hierarchical power is subsidiary units' increasing size and resource parity. Subsidiaries are less reliant on the head office, and the head office is more dependent on subsidiary units. To the extent that dependence decreases power, the corporate center and overseas units are converging in power.[15] This situation is aggravated further by the mounting intensity of direct subsidiary-to-subsidiary linkages, which lessens the head office's centrality.[16]

Decline in Common Values and Expectations As subsidiary units have increasingly accumulated distinct resources and capabilities in response to their different task environments, they have developed values and behavioral norms distinct from those in the home office.[17] On top of this, the nontrivial physical and psychic distances increasingly separating overseas units from corporate centers fuel even further the emergence of subcultures and countercultures within the modern multinational. The result is more antagonistic relations between head office and subsidiary top management teams and a natural inclination on the part of subsidiary managers to pursue subsidiary-level objectives.[18]

The upshot of all this is that the distinctive features of hierarchy in the multinational used to support traditional implementation mechanisms are increasingly collapsing. As shown in Figure 2, the emergence of a monitoring problem, the intensification of sub- and countercultures, and mounting control loss increasingly plague the multinational, making its traditional implementation tools less and less effective.

How Does Due Process Support Traditional Implementation Mechanisms? Although traditional implementation tools have become on the whole less effective, the extent to which this is true appears to be contingent in part on whether due process is exercised. Recall for a moment the due process characteristics. Two-way communication, the ability to refute the head office's viewpoints, and

[15]For an excellent discussion on the inverse relationship between power and dependence, see, for example: R.M. Emerson, "Power-Dependence Relations," *American Sociological Review* 27 (1962), pp. 31–41.

[16]For a discussion on the ways in which centrality affects power relations, see: L.C. Freeman, "Centrality in Social Networks: Conceptual Clarification," *Social Networks* 2 (1979), pp. 215–239.

[17]That business units or divisions accumulation of distinct capabilities and tasks reinforces distinct values and behavioral norms was empirically validated. See: P.R. Lawrence and J.W. Lorsch, *Organization and Environment* (Boston: Harvard University Press, 1967).

[18]See Hedlund (1986) for further elaboration of this point.

an accounting for final strategic decisions all foster open interaction and intensive information exchange between head office and subsidiary top managers. This open interaction almost forces the head office to keep rewards, punishments, and appraisal and control systems aligned with strategic decisions. An example will make this point clear.

One subsidiary president we interviewed had been requested to institute an aggressive price-reductions policy in his local market. The strategic aim was to counter an assertive price attack launched by global competitor in his company's home market. The subsidiary president understood that the execution of such a policy would benefit the overall organization—it would drain the resources of the global competitor's profit sanctuary, its home market. He also knew, however, that the policy would likely result in negative financial performance by his local operation.

The open interaction between him and the head office allowed him to address his concern directly. He stated that he understood why it was necessary for his unit to institute such a policy and that he would accept such a global strategic mission. But he argued that the execution of this mission would invalidate a sole reliance on "stand-alone" financial criteria for assessing his subsidiary unit's performance. He proposed having his unit's performance evaluated also by the strategic contribution it made to the overall organization. The head office managers and subsidiary president were able to develop a mutually acceptable set of performance evaluation criteria for his unit. In this way, the exercise of due process spurs the head office to keep traditional implementation tools aligned with strategic decisions.

Lessons from Our Field Observations

We can draw two overriding lessons from our field observations. The first is that the multinational increasingly faces a dilemma in executing its global strategies. On the one hand, the effective implementation of global strategies requires a sense of community and cooperation among all the nodes of the multinational's global network. On the other hand, multinationals are experiencing a loss in hierarchical control and an increasing independence of subsidiary units, which creates an environment of calculative, utilitarian, and frictional interunit relations. This is not particularly conducive to efficient and effective exchange. In the face of this *multinational dilemma,* we need more than traditional implementation mechanisms to make global strategies work.

The second lesson is that the exercise of due process in global strategy making seems to be a powerful, yet unexplored, way to overcome the multinational dilemma and make global strategies work. This is traceable to two sources. The first is that due process helps to overcome the exchange difficulties in the multinational by inspiring a sense of commitment, trust, and social harmony among subsidiary top managers. The second is that, beyond these salutary attitudes, the exercise of due process inspires subsidiary top managers to more readily execute strategic decisions to not only the letter but also the spirit with which they were set forth.

The Tangible Effect of Due Process

At the end of our interviews, we presented our findings to the subsidiary presidents' head office managers. These head office managers found our results fascinating and provocative. They were intrigued by our proposition that instrumental calculations of gains and losses were not the dominant driver behind subsidiary managers' actions and found it particularly interesting that subsidiary managers had placed so much emphasis on the importance of due process in global strategy making. According to these executives, it was a challenging proposition that the presence or absence of due process had the power to influence not only the important attitudes of commitment, trust, and social harmony but also subsidiary managers' actual execution of resulting decisions.

Nonetheless, despite the executives' overall excitement with our findings, underneath this ran a current of hesitation. To quote one executive:

> Your findings are provocative. But to institute due process in global strategy making is a time-consuming,

difficult task. Before I start to embark on such an attempt, I would like to have more evidence of the tangible benefits of due process than just the observations made and insights gained from your field research.

This hesitation was valid. It challenged us to go beyond our field work and empirically test our propositions. This meant conducting an extensive mail survey to develop a bigger database that could test the validity of our field observations. In short, we set out to examine whether due process exercised a positive overall effect not only on the commitment, trust, and social harmony of subsidiary top managers but also on compulsory and voluntary execution. We also set out to test whether these effects were significantly stronger or particularly potent in those subsidiary managers who received unfavorable strategic decision outcomes vis-à-vis those who received favorable outcomes. Appendix B presents a profile of our sample population, the measurements used to estimate each variable, and the type of analyses we employed.

The Results The results of our regression analyses confirmed our observation that due process in global strategy making is indeed positively related to subsidiary managers' sense of organizational commitment, trust in head office management, and social harmony between them and the head office. All slope coefficients proved to be statistically significantly ($p < .01$),[19] which is to say that the more subsidiary managers believe that due process is exercised in the global strategy-making process, the more positive attitudes they have toward head office management and the organization as a whole.

Beyond this, we also found a positive relationship between due process and compulsory and voluntary execution. All slope coefficients again proved to be statistically significant ($p < .01$). This provides evidence that the exercise of due process does more than inspire positive attitudes. It also triggers subsidiary managers to "go the extra mile" and carry out the spirit of global strategic decisions.

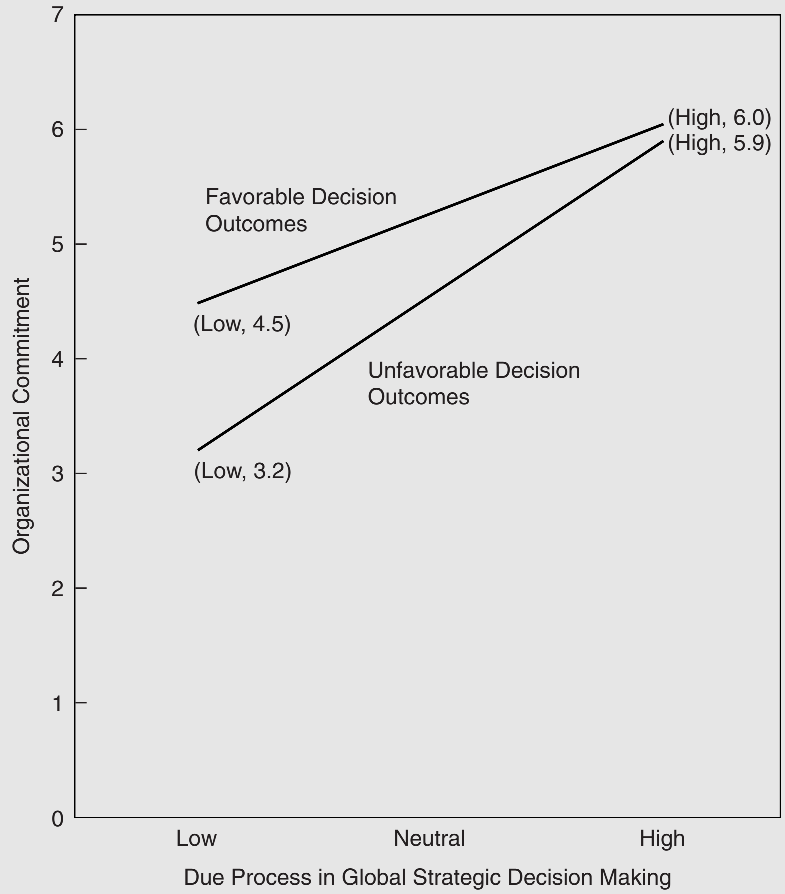
More interesting from an implementation perspective, however, are the results of another analysis. We wanted to see the effect of due process when subsidiary managers judged strategic decisions to be favorable or unfavorable for their unit. By strategic decisions we mean the strategic roles, resources, and responsibilities received by subsidiary units as a result of the last annual global strategy-making process.

During the course of our interviews, one of the most fascinating things we observed was that the effect of due process on subsidiary managers' attitudes and behavior was particularly strong precisely in those individuals who received decision outcomes viewed as unfavorable. Put differently, due process provided an especially strong "cushion of support" that mitigated the negative ramifications of unfavorable decisions by significantly inflating positive attitudes and behavior within recipients of unfavorable outcomes.[20] Figures 3a through 3c show the average commitment, trust, and social harmony scores for subsidiary top managers receiving favorable versus unfavorable strategic decision outcomes. As the figures consistently reveal, when decision outcomes were viewed as unfavorable, the exercise of due process did much to check discontent and to give "loser" subsidiary managers powerful reasons to stay committed to their organization (in Figure 3a, the mean commitment score increases from 3.2 to 5.9; $p < .01$), to have trust in head office

[19] That the exercise of due process or, as it is often referred to, procedural justice, has the power to effectuate the higher-order attitudes of commitment, trust, and social harmony finds theoretical and empirical support in other settings. See, for example: S. Alexander and M. Ruderman, "The Role of Procedural and Distributive Justice in Organizational Behavior," *Social Psychology Research* 1 (1987), pp. 177–198; and R. Folger and M. Konovsky, "Effects of Procedural and Distributive Justice on Reactions to Pay Raise Decision," *Academy of Management Journal* 32 (1989), pp. 115–130; and E.A. Lind and T.R. Tyler, *The Psychology of Procedural Justice* (New York: Plenum, 1988).

[20] This "cushion of support" effect not only finds support in the existing procedural justice literature but is recognized to be one of the most important effects of procedural justice or due process. See, for example: Lind and Tyler (1988); and T.R. Tyler, *Why People Obey the Law: Procedural Justice, Legitimacy, and Compliance* (New Haven, CT: Yale University Press, 1990).

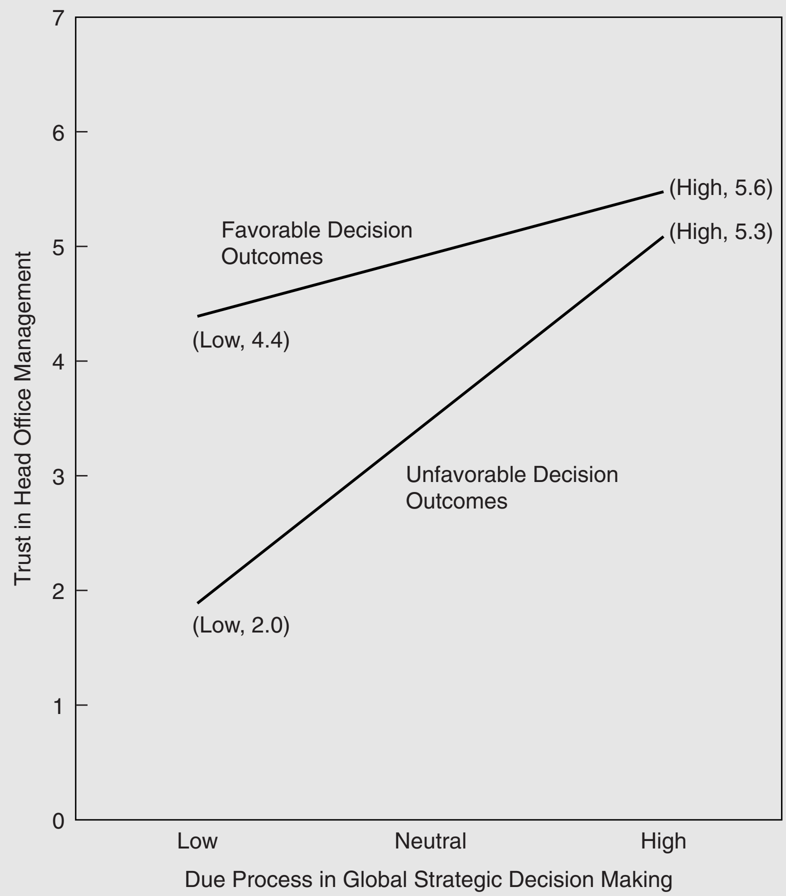
Figure 3a Due Process and Organizational Commitment



management (in Figure 3b, the mean trust score increases from 2.0 to 5.3; $p < .01$), and to cultivate an atmosphere of social harmony between them and the head office (in Figure 3c, the mean social harmony score increases from 2.3 to 4.7; $p < .01$). On the other hand, when outcomes were viewed as favorable, the due process effect, although undeniably present, was not as potent as with unfavorable outcomes. In particular, as due process heightened, the mean score for commitment increased from 4.5 to 6.0 ($p < .01$), that for trust from 4.4 to 5.6 ($p < .05$), and that for social harmony from 3.5 to 4.8 ($p < .05$). For all three salutary attitudes, the slope coefficient differential between the favorable outcome and the unfavorable outcome group also proved to be statistically significant ($p < .01$).[21]

[21]We examined and confirmed the statistical difference in the due process effect between the favorable outcome and the unfavorable outcome group for organizational commitment, trust in head office management, and social harmony. This was done using what econometricians call the Chow test, which is able to examine the statistical significance in slope differentials between the groups. In our case, test statistics of F values for all three salutary attitudes were significant at the 1 percent level and hence indicated to reject the null hypotheses that no slope coefficient difference exists between the favorable outcome and the unfavorable outcome group. For a detailed discussion on the Chow test, see: G.C. Chow, "Tests of Equality between Subsets of Coefficients in Two Linear Regression," *Econometrica* (1960), pp. 591–605.

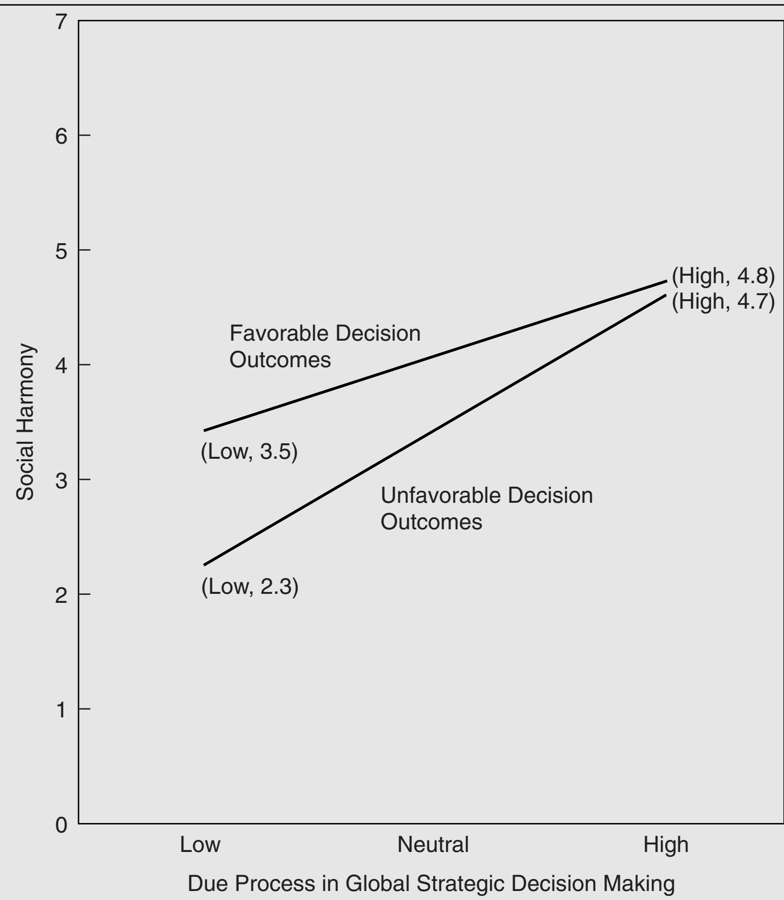
Figure 3b Due Process and Trust in Head Office Management



Figures 4a and 4b present the average compulsory and voluntary execution scores for subsidiary top managers receiving favorable versus unfavorable strategic decision outcomes. As Figure 4a reveals, the use of due process in global strategic decision making indeed appears to boost compulsory execution in managers who receive unfavorable decision outcomes to a greater extent than in those who receive favorable outcomes. Specifically, when decision outcomes were judged unfavorable, the exercise of due process did much to motivate subsidiary managers to perform the strategic roles and responsibilities assigned to their unit in accordance with the organization's formal requirements (mean compulsory execution score increased from 3.8 to 5.7; $p < .01$). On the other hand, when outcomes were viewed as favorable, the due process effect on compulsory execution, although undeniably present, was not as potent (mean score increased from 5.2 to 6.2; $p < .05$). The slope coefficient differential between the favorable outcome and the unfavorable outcome group proved to be statistically significant ($p < .05$).[22]

[22] The F value for compulsory execution was significant at the 5 percent level and hence indicated to reject the null hypothesis that no slope coefficient difference exists between the favorable outcome and the unfavorable outcome group. Ibid.

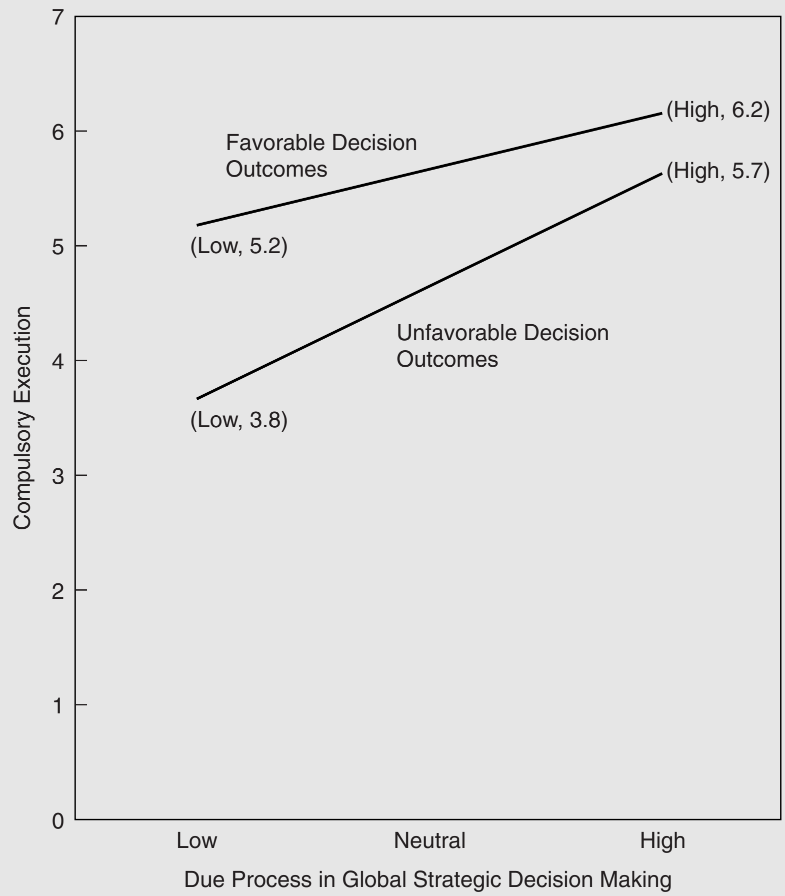
Figure 3c Due Process and Social Harmony



The same cannot be said, however, for voluntary execution. On the one hand, the voluntary execution of all subsidiary top managers significantly escalates as due process increases (in Figure 4b, mean voluntary execution score increases from 2.4 to 5.2 for recipients of unfavorable outcomes and from 2.9 to 5.5 for recipients of favorable outcomes; both significant at $p < .01$). On the other hand, the effect of due process on voluntary execution does not vary whether the decision outcomes are favorable or not. For voluntary execution, the slope coefficient differential between the favorable outcome and the unfavorable outcome group proved to be statistically not significant ($p > .10$).[23] These findings indicate that although decision outcomes do not seem to affect subsidiary managers' voluntary execution, the exercise of due process does inspire these managers to go beyond the call of duty to implement strategic decisions. This is further supported by our regression result that decision outcomes had no relationship with voluntary execution; the regression coefficient for this relationship was not statistically significant ($p > .10$).

[23] The F value for voluntary execution was not significant ($p > .10$) and hence indicated not to reject the null hypothesis that no slope coefficient difference exists between the favorable outcome and the unfavorable outcome group. Ibid.

Figure 4.a Due Process and Compulsory Execution

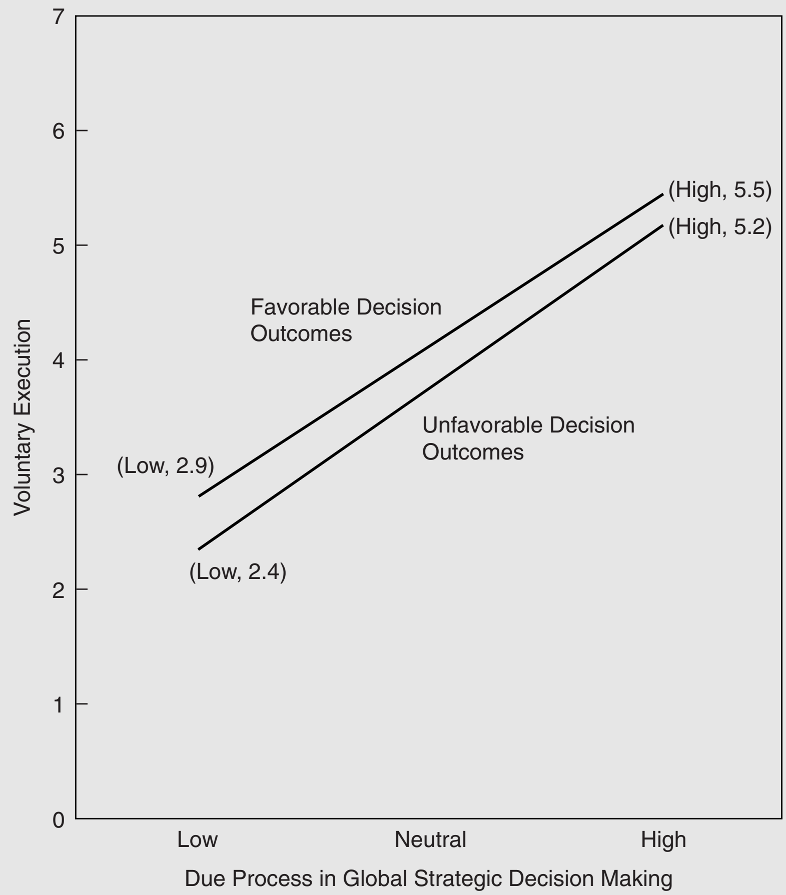


In summary, except in the case of voluntary execution, with a low level of due process, there is a big gap between the attitudes and behavior of subsidiary top managers with favorable and unfavorable decision outcomes.[24] As expected, with a low level of due process, subsidiary managers with unfavorable decision outcomes were generally dissatisfied with the head office and the overall organization and consequently felt a low level of commitment, trust, and social harmony. Not surprisingly, these same managers were not highly motivated to execute global strategic decisions to the letter or spirit with which they were set forth.

However, with a high level of due process, the picture was different. There was little gap between those managers who had received favorable and unfavorable decision outcomes in their reported scores of commitment, trust, and social harmony and compulsory and voluntary execution; all these gaps proved to be statistically not significant ($p > .10$). Hence, the gap was significantly reduced as due process heightened. Which is to say that the power of due process is strong enough to overcome the negative ramifications of unfavorable outcomes and even inspires in those subsidiary top managers

[24] Variance analysis was employed to assess the statistical significance in the mean difference between the groups.

Figure 4b Due Process and Voluntary Execution



the positive disposition necessary for global strategy execution. Moreover, whether managers received favorable or unfavorable outcomes, their degree of commitment, trust, and social harmony and compulsory and voluntary execution was much higher when due process was exercised in global strategy making than when it was not. Hence, our empirical tests strongly support our field observations.

Conclusion

How can multinationals make global strategies work? The results of this research suggest that the answer resides in the quality of the global strategy-making process itself. When deciding whether or not or to what extent to carry out global strategic decisions, subsidiary top managers accord great importance to the way in which global strategies are generated. Their overriding concern: Is due process exercised in the global strategy-making process?

In the presence of due process, subsidiary managers are motivated to implement global strategies. They feel a strong sense of organizational commitment, trust in head office management, and social harmony with their head office counterparts. These attitudes are not only important, they are the fundamental requirements for making global strategies work. Further, the exercise of due process translates directly into a high level of compulsory and voluntary execution, which is to say that due process motivates managers not only to fulfill corporate standards but also to exert voluntary effort to implement strategic decisions to the best of their ability. The power of due process in this regard is more remarkable when we consider our finding that voluntary execution was induced only by due process and not by the instrumental value of decision outcomes. In the absence of due process, the effect is just the reverse. Subsidiary top managers are frustrated with the head office, the overall organization, and the resulting global strategic decisions. This diminishes fast their willingness to execute global strategies.

But beyond this, what makes due process particularly significant for global strategy execution is that its effect on salutary attitudes and implementation behavior is especially strong in managers who receive unfavorable decision outcomes. This is one of the most critical tasks for global strategy execution. After all, it is precisely those managers who are inclined to subvert, undermine, and even sabotage global strategic decisions. This is a significant issue because the intensity of global competition and the requirements of winning global strategies require an increasing number of decisions that are perceived as unfavorable.

Examples Abound There are many examples of unfavorable decisions. In one multinational we studied, subsidiary units were recently asked to forgo their national products in favor of global core products that many units considered to be either overstandardized or overpriced for their national markets. In another multinational, the U.S. subsidiary was required to transfer a large portion of its export sales to its sister European subsidiaries. Although this substitution substantially increased capacity utilization rates in Europe and decreased the losses suffered from overcapacity there, as one U.S. executive put it, "The transfer was nothing but a loss for us." And so the list goes, endlessly on. To cite one executive:

> Our modern enterprises live in a world of global competition. The key to win here is to think globally and fully leverage our globally dispersed resources, skills, and knowledge. It is important to maximize our efficiency at the global level. To achieve this, it is unavoidable that an increasing number of subsidiaries will end up receiving unfavorable decision outcomes from their individual standpoints. No doubt, these subsidiary units will be more inclined to foot-drag and exert counterefforts than to execute global strategies. The question is then, how can we turn around these negative attitudes and inspire subsidiary units to follow and implement a global approach?

To make global strategies work, head office executives need to pay greater attention to the way they generate global strategic decisions. Although the exercise of due process by itself does not make difficult head office–subsidiary issues vanish, it does motivate subsidiary managers to accept and implement global strategies. The image of the subsidiary manager that emerges here stands in marked contrast with that of the organization man who is driven overridingly by concerns of instrumental and economic maximization. It seems that subsidiary managers are both sensitive and responsive to issues of fairness in decision-making processes. Given that both our field observations and our empirical study consistently support the importance of due process, maybe it is time that companies seriously reflect on just what they have been doing to motivate their subsidiary top managers to implement global strategies. They need to pay more heed to the importance of due process in global strategy making.

Appendix A

How did we conduct our field research? We solicited the participation of twenty-five multinationals by means of direct and indirect personal contacts with head office senior executives. Nineteen of these multinationals agreed to support this research, and they gave us the names of the subsidiary presidents heading their ten largest subsidiary operations in terms of annual sales. The dominant industries of these nineteen multinationals were: computers (five firms), packaged foods (four), electrical products (four), pharmaceuticals (three), automobiles (one), paper and wood products (one), and textiles (one).

We were able to successfully contact, via telephone, 141 of the subsidiary presidents. We guaranteed that all comments would be held strictly confidential and used solely for scientific research and that their head office managers would not be informed as to which subsidiary presidents ultimately participated in our study. Sixty-three of these subsidiary presidents were willing to participate. The remaining subsidiary presidents declined, most frequently because of a lack of time. We then held extensive interviews.

Appendix B

Sample Population We distributed the mail questionnaire to 195 subsidiary top managers. This pool comprised the 63 subsidiary presidents who participated in our field research and 132 other subsidiary top managers who directly participated in the last annual global strategic decision-making process between the head office and their national unit. The latter were also members of our nineteen original participation multinationals; their names were supplied by the 63 subsidiary presidents.[25] The titles of the subsidiary top managers ranged from president to executive vice president to director. These executives were considered to represent the key catalysts for global strategy execution in their national units.

We distributed the questionnaire within six weeks of the completion of the last annual global strategic decision-making process of our nineteen participating multinationals. Of the 195 questionnaires distributed, 142 were returned to the researchers. The questionnaire assessed the extent of due process in the last strategy-making process, subsidiary top managers' attitudes of organizational commitment, trust, and social harmony, and the perceived favorability of strategic decision outcomes.

Ten months later, just before the start of another annual global strategic decision-making process, we distributed a second questionnaire to the 142 managers who responded to our first-round questionnaire. In this one, we assessed subsidiary top managers' compulsory and voluntary execution of the global strategic decisions resulting from the preceding annual strategy-making process. Of these, 119 questionnaires were returned to the researchers and used in our analysis of the relationship between due process and compulsory and voluntary execution.[26]

Measurements

Due Process To assess whether or to what extent due process was exercised in global strategic decision making, we used a five-item measure in our survey questionnaire.[27] This involved having subsidiary top managers evaluate on a seven-point Likert-type scale each of the five identified aspects of due process, in short: (1) the extent to which the head office is knowledgeable of the subsidiary unit's local situation; (2) the extent to which two-way communication exists in the process; (3) the extent to which the head office is fairly consistent in making global strategic decisions across subsidiary units; (4) the extent to which subsidiary top managers can legitimately challenge the strategic views and decisions of the head office; and (5) the extent to which subsidiary top managers receive a full explanation for global strategic decisions.[28] The Cronbach's coefficient alpha for this five-item scale was .86.[29]

[25]For an extensive discussion on the design and administration of our mail questionnaire, see: Kim and Mauborgne (1991 and 1993a).

[26]For an extensive discussion on the design and administration of the second-wave questionnaire of our longitudinal study on subsidiary top managers' strategy execution, see: W.C. Kim and R.A. Mauborgne, "Procedural Justice, Attitudes, and Subsidiary Top Management Compliance with Multinationals' Corporate Strategic Decisions," *Academy of Management Journal,* forthcoming, June 1993b.

[27]Kim and Mauborgne (1991 and 1993a).

[28]We averaged the scores for these multiple items to estimate our due process measure. The same procedure was used for all of our other multi- item measures: organizational commitment, trust, social harmony, and strategic decision outcome favorability. For a detailed discussion on why this simple averaging approach yields an unbiased estimate, see: H.M. Blalock, "Multiple Indicators and the Causal Approach to Measurement Error," *American Journal of Sociology* 75 (1969), pp. 264–272.

[29]The Cronbach's coefficient alpha indicates the internal consistency reliability of a scale. Generally, a multi-item scale can be judged to be reliable when the value of its Cronbach alpha exceeds 0.70. Notice here that besides our due process measure, all of our other multi-item scales can be said to be reliable. For a detailed discussion on a measure's reliability, see: J. Nunnally, *Psychometric Methods* (New York: McGraw-Hill, 1978).

Organizational Commitment Nine items were used to assess the top managers' organizational commitment.[30] Sample items include, "I am willing to put in a great deal of effort beyond that normally expected in order to help this organization be successful," and "This organization really inspires the very best in me in the way of job performance." All items were assessed on a seven-point scale with anchors labeled (1) strongly disagree and (7) strongly agree. The Cronbach's coefficient alpha for this nine-item scale was .91.

Trust in Head Office Management To measure the trust subsidiary top managers have in the head office, we used four questions.[31] These are:

1. How much confidence and trust do you have in head office management?
2. Head office management at times must make decisions that seem to be against the interests of your unit. When this happens, how much trust do you have that your unit's current sacrifice will be justified by the head office's future support for your unit?
3. How willing are you to accept and follow those strategic decisions made by head office management?
4. How free do you feel to discuss with head office management the problems and difficulties faced by your unit without fear of jeopardizing your position or having your comment "held against" you later on?

Again, all four items were measured on seven-point scales. The Cronbach's coefficient alpha for this four-item scale was 94.

Social Harmony A four-item measure assessed the perceived social harmony between head office and subsidiary top managers.[32] The managers were asked to think of their relations with head office management when answering the following items: (1) how well they help each other out; (2) how well they get along with one another; (3) how well they stick together; and (4) the extent to which conflict characterizes their relations. These items were measured on seven-point scales with the fourth item reversely scored. The Cronbach's coefficient alpha for this four-item scale was .87.

Strategic Decision Outcome Favorability Four items assessed the perceived favorability of global strategic decisions received by subsidiary units as a result of the last annual global strategic decision-making process.[33] Subsidiary top managers were asked to assess the extent to which the global strategic roles, responsibilities, and resources allocated to their unit: (1) reflected their unit's individual performance achieved; (2) mirrored their unit's relative contribution to the overall organization; (3) exceeded their unit's expectations; and (4) were absolutely favorable. All four items were measured on seven-point scales. The Cronbach's coefficient alpha for this four-item scale was .83.

Compulsory Execution To assess the extent to which each subsidiary top manager carried out global strategic decisions in accordance with their formally required corporate standards, two questions were posed. First, for each of eight major activities (marketing and sales, research and development, manufacturing, purchasing, cost-reduction programs, general cash-flow utilization, human resource management, and other administrative activities), subsidiary top managers were asked to respond on a seven-point (1 = not at all, 7 = completely) scale to the following question: "Please try to recall as accurately as possible your overall

[30] The nine-item measure used to assess organizational commitment was developed by: R.T. Mowday, R.M. Steers, and L.W. Porter, "The Measurement of Organizational Commitment," *Journal of Vocational Behavior* 14 (1979), pp. 224–247.

[31] The items used to measure trust were drawn from the interpersonal trust measures of: W.H. Read, "Upward Communication in Industrial Hierarchies," *Human Relations* 15 (1962): 3–15; and R. Likert, *The Human Organization* (New York: McGraw-Hill, 1967).

[32] The indicators used to measure social harmony were drawn from the cohesiveness index developed by: S.E. Seashore, *Group Cohesiveness in the Industrial Work Group* (Ann Arbor: University of Michigan Press, 1954); and C. Cammann, M. Fichman, G. Douglas, and J.R. Klesh, "Assessing Attitudes and Perceptions of Organizational Members," in *Assessing Organizational Change,* eds. S.E. Seashore, E.E. Lawler, P.H. Mirvis, and C. Cammann (New York: John Wiley & Sons, 1983).

[33] The four-item measure used to assess strategic decision outcome favorability was originally developed by: Kim and Mauborgne (1991).

behavior and actions taken since the preceding annual global strategic-decision process between the head office and your national unit. Then for each of the eight outlined activities indicate the extent to which you executed these decisions in accordance with your organization's required standards. Note that you should not include in this assessment any efforts that may have been extended beyond your organization's required standards in order to achieve optimum performance in these activities." Organization was defined here as the multinational.

For each of these eight activities, we then had subsidiary top management rate on a five-point scale, ranging from "1 = not important" to "5 = extremely important," the degree of importance of each of these activities to the successful fulfillment of their overall job requirements. This assessment is important because although each of our respondents was a top manager with overarching responsibilities for and involvement in overall subsidiary unit operations across these activities, many reported having full responsibility for some activities but having only limited responsibility in the sense of giving final approval in other activities. Accordingly, to assess the extent of each manager's compulsory execution, these importance ratings were used as weights to reflect each activity's relative contribution or importance to the fulfillment of each manager's overall job requirements. Using these weights, we then obtained each manager's weighted-average compulsory execution score. Specifically, for each manager, we first multiplied the manager's compulsory execution score on each of the eight activities by his or her corresponding importance ratings and then added these weighted execution scores. Finally, we divided this added figure back by the sum of these importance ratings to arrive at each manager's weighted-average compulsory execution score.[34]

[34]The use of a multidimensional approach with criterion weights to measure both compulsory and voluntary execution is in line with Steers's advice and seemed particularly appropriate for taking into account subsidiary top managers' different levels of involvement in carrying out these activities and hence their different levels of contribution to the execution of these activities in accordance with their formal job requirements. See: R.M. Steers, "Problems in the Measurement of Organizational Effectiveness," *Administrative Science Quarterly* 20 (1975), pp. 546–558.

Voluntary Execution To assess the extent to which subsidiary top managers exerted voluntary effort to carry out global strategic decisions to the best of their abilities, we used a similar approach to that used in our assessment of compulsory execution. First, for each of the eight major activities, the managers were asked to respond on a seven-point scale (1 = not at all, 7 = greatly) to the following question: "Please try to recall as accurately as possible your overall behavior and actions taken since the preceding annual global strategic decision process between the head office and your national unit. Then for each of the eight outlined activities indicate the extent to which you voluntarily exerted effort beyond the formally required standards of your organization to execute global strategic decisions to the best of your abilities. Rephrased, to what extent did you willingly exert energy, exercise initiative, and devote your effort beyond that which is formally required to achieve optimum performance in your execution of global strategic decisions in each of these activities?"

Using the same question on dimensional importance described above for compulsory execution to obtain weights, we derived a weighted-average measure of each manager's voluntary execution of global strategic decisions. The process used to derive this weighted-average measure of voluntary execution mirrors that used to arrive at our weighted-average measure of compulsory execution.[35]

Analyses We used two tests to establish the effect of due process on the managers' attitudes and behavior. First, we performed regression analyses to see whether due process positively correlated with the managers' attitudes of organizational commitment, trust in head office management, and social harmony between them and head office management and whether due process was also related to the managers' compulsory and voluntary execution of the resulting decisions.

[35]Ibid.

Second, we tested whether due process produces a "cushion of support" that enhances salutary attitudes and execution to a greater extent in those managers who received unfavorable decision outcomes than those who received favorable outcomes. To perform this test, we first divided respondents into two groups based on the perceived favorability or unfavorability of strategic decision outcomes received in the last annual strategy-making process. Those managers with outcome favorability scores above the sample mean were classified as recipients of favorable strategic-decision outcomes; those below the sample mean were classified as recipients of unfavorable outcomes. We then further split our respondents based on the perceived degree of due process exercised. Respondents with due process scores above the sample mean were treated as experiencing a high level of due process, whereas those having due process scores below the sample mean were treated as experiencing a low level of due process. Finally, we calculated and compared the mean levels of reported organizational commitment, trust in head office management, social harmony, and compulsory and voluntary execution for each of our four groups: the high outcome favorability–high due process group; the high outcome favorability–low due process group; the low outcome favorability–high due process group; and the low outcome favorability–low due process group. As is described in the article, we used variance analysis and the slope coefficient differential test to test differences between these four groups. We observed no evidence for systematic differences in contextual variables such as industry type and subsidiary size across these four groups.

Reading 4-2 Building Ambidexterity into an Organization

Julian Birkinshaw and Cristina Gibson

The technological downturn, political turmoil and economic uncertainty of the last five years have reaffirmed to managers the importance of *adaptability*—the ability to move quickly toward new opportunities, to adjust to volatile markets and to avoid complacency. But while adaptability is important, it is not enough. Successful companies are not just nimble, innovative and proactive; they are also good at exploiting the value of their proprietary assets, rolling out existing business models quickly and taking the costs out of existing operations. They have, in other words, an equally important capability we call *alignment*—a clear sense of how value is being created in the short term and how activities should be coordinated and streamlined to deliver that value.

For a company to succeed over the long term, it needs to master both adaptability and alignment—an attribute that is sometimes referred to as *ambidexterity*.[1] For example, Finland's Nokia Corp. is trying out a vast array of new mobile technology

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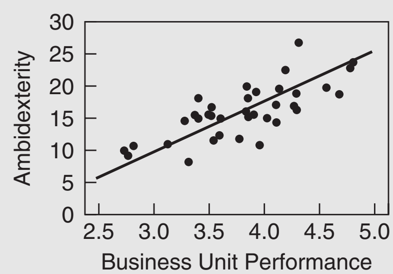
About the Research

Ambidexterity has been seen as a desirable organizational trait for decades, but the concept has typically been associated only with the structural separation of activities. We offer a complementary way of thinking about ambidexterity that sees it emerging through a company's organizational context as well as through its structure.

Our research was conducted over a three-year period in cooperation with researchers from the Center for Effective Organizations (Marshall School of Business, University of Southern California) and Booz Allen Hamilton Inc., and with the collaboration of the World Economic Forum. We adopted a systematic, multiphase research design, consisting of (1) interviews with top executives in 10 multinational companies; (2) interviews in two to seven business units in each corporation; (3) development of a detailed survey to measure organization context, ambidexterity and performance; (4) administration of the survey to a stratified, random sample of 50–500 employees at four hierarchical levels in each business unit; (5) identification and understanding of the key context characteristics through qualitative analysis of interview notes and quantitative analysis of survey data; and (6) feedback sessions in each company. The total number of survey respondents was 4,195 individuals across 41 business units in the 10 multinational companies.

Ambidexterity and Performance

To examine the link between ambidexterity and performance, we surveyed two separate groups of individuals. In each business, we interviewed midlevel managers about their company's alignment and adaptability, asking them to rate a variety of factors. We then multiplied the overall alignment and adaptability ratings to arrive at a measure of the company's ambidexterity. Similarly, we then asked a set of senior managers to rate business performance. We examined the correlation between ambidexterity and performance across the 41 business units and found it to be highly significant ($r = 0.76$, $p < 0.01$), as shown below.



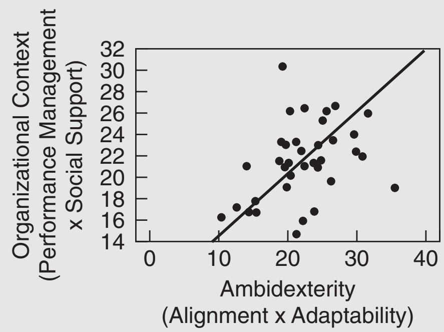
Note: Business unit performance is measured on a scale from 1 (very low) to 7 (very high). Ambidexterity is the product of alignment and adaptability, each one measured on a scale from 1 (very low) to 7 (very high).

Organizational Context and Ambidexterity

The second stage of statistical analysis sought to test two hypotheses. The first argued that a supportive organizational context—characterized by a combination of performance management and social support—would be associated with a higher level of ambidexterity. To test this, we asked respondents questions about a range of contextual factors, out of which we created two indexes—one for performance management, the other for social support. We multiplied these two to create an overall index for organizational context. The correlation between organizational context and ambidexterity across the 41 business units was highly significant ($r = 0.55$, $p < 0.01$), as shown on next page.

The second hypothesis argued that ambidexterity would mediate the relationship between organizational context and performance. To test this, we undertook a series of regression analyses, which showed that (a) ambidexterity is correlated with performance, (b) organizational context is correlated with ambidexterity, (c) organizational context is correlated with performance and, the critical step, (d) when ambidexterity and organizational context *together* are analyzed as predictors of performance, only ambidexterity has a significant influence. This is known as *full mediation,* and it demonstrates that the influence of organizational context on performance only occurs through the creation of ambidexterity.

For a full description of the research and statistical analyses, please refer to C.B. Gibson and J. Birkinshaw, "The Antecedents, Consequences and Mediating Role of Organizational Ambidexterity," *Academy of Management Journal* 47, no. 2 (2004): 209–226.



Note: Ambidexterity is the product of alignment and adaptability, each one measured on a scale from 1 (very low) to 7 (very high). Organizational context is the product of performance management and social support, each one measured on a scale from 1 (very low) to 7 (very high).

offerings, while continuing to invest in its dominant handsets franchise. GlaxoSmithKline Plc is experimenting with alternative organization models, alliance partners and technologies in its search for new blockbuster drugs, and it is also pushing hard to maximize the return from its existing drug portfolio.

The trouble is, it's difficult to find the right balance between adaptability and alignment. Focus too much on alignment and the short-term results will look good, but changes in the industry will blindside you sooner or later. Lloyds TSB Bank Plc, based in the United Kingdom, delivered spectacular shareholder returns throughout the 1980s and 1990s, in large part through CEO Brian Pitman's single-minded focus on return on equity. But little attention was paid to understanding changing customer needs or to the morale of the workforce, which ultimately undermined the company's performance. From 1998 to 2003, Lloyds TSB lost 60% of its market value.

Similarly, too much attention to the adaptability side of the equation means building tomorrow's business at the expense of today's. Consider the case of Sweden's Ericsson, which has led the technological development of the mobile telephony industry. Ericsson developed one of the first analog mobile systems; it led the industrywide development of the global system for mobile communication; and it has pioneered general packet radio system and third-generation mobile technology standards. But the impressive growth in sales in Ericsson's systems business masked a high-cost and bloated organizational structure. At its peak, the R&D organization employed 30,000 people in approximately 100 technology centers with considerable duplication of effort. Adaptability, in other words, had taken precedent over alignment, and the subsequent crash in the telecom industry meant that Ericsson was hit harder than most. Since its peak in 2000, Ericsson has laid off around 60,000 employees and closed most of its technology centers in a bid to restore the profitability of its current businesses.

Two Forms of Ambidexterity

The concept of organizational ambidexterity has been around for years, but the evidence suggests that many companies have struggled to apply it. The standard approach is to create *structural ambidexterity,* that is, to create separate structures for different types of activities.[2] For example, the core business units are given responsibility for creating alignment with the existing products and markets; and the R&D department and business development group are given the job of prospecting for new markets, developing new technologies and keeping track of emerging industry trends. Structural separation is necessary, the argument goes, because the two sets of activities are so dramatically different that they cannot effectively coexist.

But separation also can lead to isolation, and many R&D and business-development groups have failed to get their ideas accepted because of their lack of linkages to the core businesses. Many companies have experimented with variants of the structural ambidexterity model. Some pull individuals out of their current jobs to work in a dedicated cross-functional team for a limited period of time. Others separate the different types of activities within a single business unit—for example, they create a small business-development team attached to a business unit. These approaches avoid the extreme form of separation that is typical of dual structures. But they nonetheless remain top-down in nature in that they rely on business-unit managers to judge how best to divide employees' time between one set of activities and another.

In an attempt to shed new light on the phenomenon, we have developed and explored the concept of *contextual ambidexterity,*[3] which calls for individual employees to make choices between alignment-oriented and adaptation-oriented activities in the context of their day-to-day work. (See "About the Research.") In business units that are either solely aligned *or* solely adaptive, employees have clear mandates and are rewarded accordingly. But in a business unit that is ambidextrous, the systems and structures are more flexible, allowing employees to use their own judgment as to how they divide their time between adaptation-oriented and alignment-oriented activities. For example, should they focus on current customer accounts to meet quota, or should they nurture new customers with slightly different needs? To foster this sort of ambidexterity on the individual level, a much greater level of attention has to be paid to the human side of the organization.

Contextual ambidexterity differs from structural ambidexterity in many important ways (see "Structural Ambidexterity vs. Contextual Ambidexterity," p. 425), but the two approaches are best viewed as complementary. Indeed, many successful companies, including Hewlett-Packard, 3M and Intel, use a combination of both approaches to deliver simultaneously on the needs for alignment and adaptability.

Contextual Ambidexterity Our research, which included interviews with a wide variety of employees, ranging from senior executives to front-line workers, identified four ambidextrous behaviors in individuals:

Ambidextrous Individuals Take the Initiative and Are Alert to Opportunities Beyond the Confines of Their Own Jobs For example, a regional sales manager for a large computer company, in discussions with one large client, became aware of the need for a new software module that no company currently offered. Rather than try to sell the client something else or just pass the lead on to the business development team, he took it upon himself to work up a business case for the new module; once he received the goahead, he moved full time into the development of the product.

Ambidextrous Individuals Are Cooperative and Seek Out Opportunities to Combine Their Efforts with Others A large beverage company's marketing manager for Italy was primarily involved in supporting a newly acquired subsidiary, and she was frustrated with the lack of contact she had with her peers in other countries. Rather than wait for someone at headquarters to act, she began discussions with peers in other countries that led to the creation of a European marketing forum. This group met quarterly to discuss issues, share best practices and collaborate on marketing plans.

Ambidextrous Individuals Are Brokers, Always Looking to Build Internal Linkages On a routine visit to the head office in St. Louis, a Canadian plant manager for a large consumer products company heard discussions about plans for a $10 million investment in a new tape manufacturing plant. He inquired further into these plans, and on his return to Canada, he called a regional manager in Manitoba, who he knew was looking for ways of building his business. With some generous support from the Manitoba government, the regional manager bid for, and ultimately won, the $10 million investment.

Ambidextrous Individuals Are Multitaskers Who Are Comfortable Wearing More than One Hat For example, the operations manager in France for a major coffee and tea distributor was initially charged with making that plant run as efficiently as possible, but he took it upon himself to identify new value-added services for his clients. He developed a dual role for himself, managing operations four days a week and on the fifth developing a promising electronic module that automatically reported impending problems inside a coffee vending machine. He arranged corporate funding, found a subcontractor to develop the software and then piloted the module in his own operations. The module worked so well that operations managers in several other countries subsequently adopted it.

These four attributes—which collectively describe an ambidextrous employee—have several important commonalities. First, they constitute acting outside the narrow confines of one's job and taking actions in the broader interests of the organization. Second, they describe individuals who are sufficiently motivated and informed to act spontaneously, without seeking permission or support from their superiors. Third, they encourage action that involves adaptation to new opportunities but is clearly aligned with the overall strategy of the business. Such behaviors are the essence of ambidexterity—and they illustrate how a dual capacity for alignment and adaptability can be woven into the fabric of an organization on the individual level.

Still, an individual's ability to exhibit ambidexterity is facilitated (or constrained) by the organizational context in which he or she operates, so contextual ambidexterity can also be diagnosed and understood as a higher-order organizational capability. At the *organizational level,* contextual ambidexterity can be defined as the collective orientation of the employees toward the simultaneous pursuit of alignment and adaptability. It is manifested in the behaviors of hundreds of individuals in the ways described above and in the unwritten routines that develop in organizations. In this respect it is analogous to the well-established concept of *market orientation,* which is a collective orientation of people throughout a business toward the gathering, interpretation and dissemination of market knowledge.[4] And just as with market orientation, ambidexterity is a potentially important capability for contributing to long-term performance.

Structural Ambidexterity vs. Contextual Ambidexterity

	Structural Ambidexterity	**Contextual Ambidexterity**
How is ambidexterity achieved?	Alignment-focused and adaptability-focused activities are done in separate units or teams	Individual employees divide their time between alignment-focused and adaptability-focused activities
Where are decisions made about the split between alignment and adaptability?	At the top of the organization	On the front line—by salespeople, plant supervisors, office workers
Role of top management	To define the structure, to make trade-offs between alignment and adaptability	To develop the organizational context in which individuals act
Nature of roles	Relatively clearly defined	Relatively flexible
Skills of employees	More specialists	More generalists

The traditional view of organizational ambidexterity revolves around a structural separation of initiatives and activities. The notion of contextual ambidexterity, which manifests on an individual level, represents a complementary process.

So what does an ambidextrous organization look like? There are numerous paths to ambidexterity, but consider two examples from companies whose units rated very high in our research on both contextual ambidexterity and performance.

Renault, the French automobile company, went through a radical transformation during the 1990s.When Louis Schweitzer became CEO in 1992, the state-owned company was languishing. Schweitzer cut costs through a number of well-publicized plant closures, but he also invested in new-product development (leading to such models as the Espace and Megane) and began the search for a strategic partner to take Renault into the top tier of the industry. After an abortive merger with Volvo in 1993, Renault gained control of a struggling Nissan in 1998 and, to the surprise of many observers, quickly turned around its performance. By 2001, the Renault-Nissan Alliance had joined the ranks of industry leaders and was one of the most profitable auto companies in the world.

How did the transformation take place? Schweitzer developed a simple and consistent strategy built around what he called the "seven strategic goals." The strategic planning and budgeting processes, and the bonuses and stock option plans, were all aligned with these goals. The communication of the message was, in the words of one executive, "doggedly consistent."

At the same time, the company developed what one executive called a "deep desire to adapt." The seven strategic goals were updated every two or three years, the organization had an informal style of management in which expressing alternative views was encouraged and managers developed a self-critical approach, always looking to improve. The result was an organization that became proficient at continually making small adaptations to its strategy without losing alignment.

As a second example, Oracle Corp. is the leading enterprise software company in the world with more than $10 billion in revenues. Oracle's rapid growth, and the continuing presence of its founder, Larry Ellison, created an entrepreneurial style of management that eschewed formal structures and processes wherever possible. And perhaps because of this, the concept of ambidexterity sits easily with its senior executives. As one of them put it, "We align around adaptability."

The company has shown a "remarkable ability to turn on a dime." Consider Oracle's shift into e-business in 1999 and its current shift into services. Oracle achieved this adaptability by hiring very smart people, setting aggressive but not unrealistic targets and avoiding too much formalization. As one executive explained, "Moving at this high rate of speed makes it impossible to maintain formal processes. Instead, a lot of people are making unilateral decisions." At the same time, though, the objectives, goal setting programs and incentive systems are carefully aligned. "Employees in all lines of business have a clear idea of the company's objectives," observed one manager.

Renault and Oracle are not alone. Tesco Plc, the leading grocery chain in the United Kingdom, delivers industry-leading profit margins through a well-aligned operational strategy while continuing to push the development of new store concepts and new product lines. 3M Co. is famous for its highly innovative work practices, also delivering impressive margins through its systematic financial control and continuous improvement systems. An ambidextrous organizational context can be achieved through a variety of means, but they all share one thing in common: They enable individuals in the organization to exhibit initiative, cooperation, brokering skills and multitasking abilities.

Building Contextual Ambidexterity

How can managers begin to think about building contextual ambidexterity into their organizations? Sumantra Ghoshal and Chris Bartlett define context as the often invisible set of stimuli and pressures that motivate people to act in a certain way.[5] Along that line of thinking, top managers shape organizational context through the systems, incentives and controls they put in place and through the actions they take on a day-to-day basis. It is then reinforced through the behaviors and attitudes of people throughout the organization.

Ghoshal and Bartlett argue that four sets of attributes—stretch, discipline, support and trust—interact to define an organization's context. In combination, these attributes create two dimensions of organizational context: The first, *performance management* (a combination of stretch and discipline), is concerned with stimulating people to deliver high-quality results and making them accountable for their actions; the second, *social support* (a combination of support and trust), is concerned with providing people with the security and latitude they need to perform.

Performance management and social support are equally important and mutually reinforcing. The strong presence of each will create a *high-performance organizational context* that gives rise to a truly ambidextrous organization. However, if there is an imbalance in these organizational characteristics, or a lack of both, a less than optimal organizational context will exist. (See "Four Types of Organizational Context.")

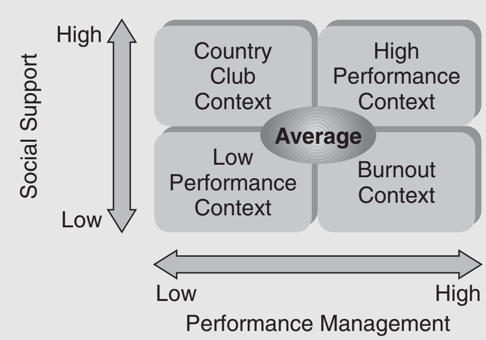
For example, a demanding, results-driven orientation that lacks social support will create a *burnout context*. Many people will perform well for a limited time in such a scenario, but its depersonalized, individualistic and authority-driven nature typically results in a high level of employee turnover, making ambidexterity difficult to achieve. Conversely, strong social support without high-performance expectations will engender a *country-club context*[6] in which employees benefit from and enjoy a collegial environment but rarely produce up to their potential. Companies in this position also have low ambidexterity and produce satisfactory but lackluster results. An absence of both a high-performance ethic and social support will, of course, produce a *low-performance organizational context*. Employees are unlikely to be either aligned or adaptive, let alone ambidextrous.

Creating a High-Performance Organizational Context

While performance management and social support factors do not directly create high performance, they do shape the individual and collective behaviors that over time enable ambidexterity, which does lead to superior performance. The challenges of building such a high-performance context are illustrated by the cases of Renault and Oracle.

Renault's transformation during the 1990s involved a shift from the country-club to the high-performance context. Until 1990, employees had viewed the company as a comfortable and secure place to work, with an informal atmosphere. Over the following 10 years, a number of changes were brought about, primarily through top-down initiatives revolving around cost reduction and quality and through greater focus on, and commitment to, key strategic objectives. One executive commented that his business unit was run as a "commando-type organization—appraisal and evaluation interviews are run in a pyramidal form and compensation is [now] geared toward short-term objectives."Most of these changes were instituted through a new executive team that gave people more structure, which led to a focus on new products and new opportunities as a means of delivering on the more ambitious goals. Stated slightly differently, the emphasis during the transition was placed on performance management but building on the social support that had existed in the early 1990s. Indeed, two of

Four Types of Organizational Context



The more a company emphasizes performance management and social support, the more likly are its employees to behave ambidextrously—aligned and adaptive—and the more likely the organization is to achieve high performance. A deficiency of either performance management or social support will create less than optimal contests for ambidexterity.

Schweitzer's seven goals were concerned with the internal organizational context (develop a coherent and open group; work more effectively together).

Compare this to Oracle, which was positioned on the cusp between the high-performance and burnout contexts. Performance expectations were very high, people were well rewarded and the style of working was competitive and aggressive. One executive, for example, compared the business to "the engine of a Ferrari, which revs at very high rpm but can burn out at any minute." But at the same time, employees rated the company moderately high on social support, citing the development of a balanced-scorecard system and the leadership forums at which the top 275 managers gather to share ideas.

The contrast between these two companies raises three critical points:

First, there is no single pathway to ambidexterity: Renault achieved it by building a performance context around its existing social support; Oracle built a performance context first, then looked for ways of building support and trust across the organization.

Second, there is no single leadership model for an ambidextrous organization. Larry Ellison is charismatic and directive; Louis Schweitzer is no less powerful, but he works in a more collegial manner.

Third, despite all their differences, Renault and Oracle both exhibit a clear and simple set of priorities. In our survey analysis, Oracle employees emphasized goal setting, individual performance appraisal and risk management; Renault employees highlighted capital allocation, recruiting and vision. Obviously, the choice of focal elements is important, but even more important, our evidence suggests, is the consistency with which they are applied and the number of employees they affect.

Escaping From Suboptimal Contexts

Many companies find themselves mired in contexts that do not effectively support ambidexterity and high performance. Those companies have to look for ways to engineer dramatic shifts in the behaviors they encourage.

The burnout context, for example, puts so much emphasis on performance management that social support systems are either neglected or never put in place. Eventually, performance suffers as exhausted and disenchanted employees have neither the capacity nor the incentive to execute or innovate. Clifford Chance Llp, the world's largest law firm, had clearly reached this stage in October 2002 when an internal memo was leaked to the press revealing that staff in the New York office were expected to bill 2,420 hours per year—or roughly 10 hours per day. The memo explicitly stated that "the stress of billable hours is dehumanizing and verging on an abdication of our professional responsibilities."

Scotch Inc. (not its real name), one of the largest consumer products companies in the world, provides another example of burnout. Scotch had grown quickly during the late 1990s through a strategy of focusing on a small number of core brands and rolling them out quickly on a global basis. By 2000, however, growth was slowing, and the foreign subsidiary managers were starting to voice some concerns. The managers had limited influence over the positioning of the global brands in their local markets; they were short of resources; and they felt the strategic planning process was too top-down. At the same time, the growth goals were demanding, and there was little or no tolerance for failure. The emphasis on performance management had led to solid growth, but executives were concerned about where the next phase of growth would come from. Scotch senior management recognized the potential for burnout and introduced several initiatives to increase the quality social support offered by the organizational context, including changes to the strategic planning process, introduction of systems for sharing best practices among subsidiaries and refinement of programs for professional development.

The country-club context—in which there is a strong sense of support and trust, but no one works too hard and mediocre performance is tolerated—can be as dysfunctional as the burnout context. Many government agencies, universities and state-owned companies fall naturally into this category

Diagnosing Your Organizational Context

How does your company rate in terms of organizational context? To get a quick indication, answer the questions below, calculate your average scores, and plot your answers on the graph.

EVALUATE PERFORMANCE MANAGEMENT CONTEXT

Managers in my organization . . .	*Not at all*			*Neutral*			*To a very great extent*
Set challenging/aggressive goals	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Issue creative challenges to their people instead of narrowly defining tasks	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Make a point of stretching their people	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Use business goals and performance measures to run their businesses	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Hold people accountable for their performances	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Encourage and reward hard work through incentive compensation	**1**	**2**	**3**	**4**	**5**	**6**	**7**

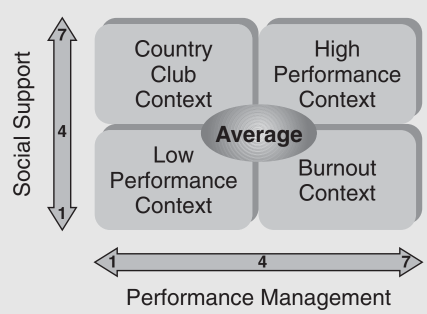
Average score for performance management context ____________

EVALUATE SOCIAL SUPPORT CONTEXT

Managers in my organization . . .	*Not at all*			*Neutral*			*To a very great extent*
Devote considerable effort to developing subordinates	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Push decisions down to the lowest appropriate level	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Have access to the information they need to make good decisions	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Quickly replicate best practices across organizational boundaries	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Treat failure in a good effort as a learning opportunity, not as something to be ashamed of	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Are willing and able to take prudent risks	**1**	**2**	**3**	**4**	**5**	**6**	**7**

Average score for social support context ____________

PLOT SCORES ON THE GRAPH



as do a fair number of commercial organizations. For example, Lufthansa AG had such a culture during the late 1980s in large part because, as *the* state-owned airline, it was too important to fail. When Jurgen Weber took over as CEO in 1991, however, he clearly demonstrated that the company was very close to bankruptcy. He put a performance management dimension in place, and the context began to shift toward high performance.[7]

Similarly, Cowes Ltd. (not its real name), a formerly stateowned European dairy-products company, sold farm produce to consumer goods companies, typically within a strict set of regulations and quotas. Faced with impending deregulation, however, Cowes' country-club culture put the company in a noncompetitive position. Senior executives realized this and made two significant changes: They broke the company down into distinct profit and loss units and instituted a pay-for-performance scheme for unit managers, and they introduced innovation processes to seek out new sources of top-line growth.

Although the strategies employed by Scotch, Lufthansa and Cowes were initiated in a top-down fashion, each sought—by emphasizing performance management alongside social support—to create a high-performance context in which ambidextrous behavior on the *individual* level would be encouraged and rewarded.

At some companies, there is not only little concern for performance, but also no sense of trust or support among the employees. That is the worst of both the country-club and burnout syndromes and constitutes a *low-performance context* in which ambidexterity is impossible. For example in one company we studied, there was evidence of inconsistent messages from top management (making it hard to create trust) and a sense that the business lacked the ambition or focus needed to generate stretch. As one manager said, "There is no overarching vision, each division devises its own vision and objectives." In another company, there was evidence of a lack of follow-through when using management systems (making it hard to create discipline). For example, there had been a number of new initiatives, which according to one manager "had lost accountability and steam" within less than a year. Support systems, in terms of providing training, feedback sessions and information across the functions, could be identified in both companies, but were insufficient on their own to develop an effective organizational context.

Companies that find themselves in a low-performance context must place an immediate priority on developing improved performance management. Social support mechanisms can follow well before the risk of burnout becomes an issue.

Pathways to Ambidexterity

For executives who are seeking to build an ambidextrous organization, there are five key lessons that emerge from our work.

Diagnose Your Organizational Context Before an organization can take steps toward a high-performance context, it must discover where it currently stands in terms of performance management, social support and the balance between the two. A simple diagnostic tool (see "Diagnosing Your Organizational Context") that involves responses from a large cross-section of people throughout the company will produce a basic, helpful quantitative analysis. It can be supplemented with a more qualitative discussion of the context in the organization. To the extent that the two analyses reinforce each other, a reliable picture emerges of what changes need to be made along what lines to move the organization toward high performance.

Focus on a Few Levers, and Employ Them Consistently We found no evidence that specific organizational levers, such as incentive compensation or risk management, were consistently linked to success. There are many ways to build an organizational context that enables ambidexterity. The higher-performing companies, however, are those that focus consistently on just a few levers. For example, Scotch decided to focus on levers intended to bolster its social support side of the equation: professional development, knowledge transfer and a more participative strategic-planning process. The more consistently those are applied, the easier it will be for employees across the organization to make sense of the changes that are under way. Consistency is crucial since organizational context does not, on its own, create high performance but enables the individual-level ambidexterity that, over time, leads to high performance.

Build Understanding at all Levels of the Company In our survey research, we found that the lower the respondent was in the corporate hierarchy, the lower he or she rated the organization's ambidextrous characteristics—a pattern we call the erosion effect. Intriguingly, the magnitude of the erosion effect varied with the performance of the company. In lower-performing companies, front-line employees rated elements of organizational context an average of 1.5 points lower on a 7-point scale than did their top-management counterparts. In the more ambidextrous and higher-performing companies, the rating disparity was typically 0.5 points or less.

The interview component of the study revealed that the erosion effect is a measure of the consistency and quality of communication in the organization. That is, for organizational context to be effective in creating ambidexterity, its message has to be disseminated clearly and consistently throughout the organization.Unless lower-level employees genuinely understand the initiatives of top management, the initiatives will have a minimal impact on individuals' capacity for ambidexterity.

View Contextual Ambidexterity and Structural Ambidexterity as Complements Almost all the previous research on ambidexterity has focused on structural separation between alignment-oriented and adaptability-oriented activities. There is evidence that this approach can be highly effective, but there is also evidence that it can create as many problems as it solves. For example, many large companies, including British American Tobacco, Royal & SunAlliance and British Airways, established corporate venture units during the dot-com boom to nurture new business ideas, but as those units lacked sufficient connective tissue with the core business, most eventually became isolated and irrelevant to the company's strategy.[8]

Contextual ambidexterity isn't an alternative to structural ambidexterity but rather a complement. Structural separation may at times be essential, but it should also be temporary, a means to give a new initiative the space and resources to get started. The eventual goal should be reintegration with the mainstream organization as quickly as possible. Contextual ambidexterity can enhance both the separation and reintegration processes.

View Contextual Ambidexterity Initiatives as "Driving Leadership," Not as Being "Leadership-Driven" Ambidexterity arises not just through formal structure or through the vision statements of a charismatic leader. Rather, it is achieved in large part through the creation of a supportive context in which individuals make their own choices about how and where to focus their energies. Leadership, in other words, becomes a characteristic displayed by everyone in the organization.[9] The impetus toward ambidexterity may sometimes be driven by top-down initiatives, but the goal is to allow leadership to emerge from the organization at all levels and for that ubiquitous, emergent leadership to be inherently ambidextrous.

[1]A number of business writers have used the term "ambidexterity" over the years. See R.B. Duncan, "The Ambidextrous Organization: Designing Dual Structures for Innovation," in "The Management of Organization Design: Strategies and Implementation. Volume 1," eds. R.H. Kilmann, L.R. Pondy and D. Slevin (New York: North-Holland, 1976), 167-188; E. McDonough III and R. Leifer, "Using Simultaneous Structures To Cope With Uncertainty," Academy of Management Journal 26, no. 4 (1983): 727-735; M.L. Tushman and C.A. O'Reilly III, "The Ambidextrous Organization: Managing Evolutionary and Revolutionary Change," California Management Review 38, no. 4 (1996): 8-30; and C.A. O'Reilly III and M.L. Tushman, "The Ambidextrous Organization," Harvard Business Review 82 (April 2004): 74-82. For a full description of the research and statistical analyses, please refer to C.B. Gibson and J. Birkinshaw, "The Antecedents, Consequences and Mediating Role of Organizational Ambidexterity," Academy of Management Journal 47, no. 2 (2004): 209-226.

[2]Duncan argued that ambidexterity should be managed through "dual structures." The concept of structural separation between different types of activities is also evident in much of the organization literature. See P.R. Lawrence and J.W. Lorsch, "Organization and Environment: Managing Differentiation and Integration" (Boston: Harvard University Press, 1967); P.F. Drucker, "Innovation and Entrepreneurship: Practice

and Principles" (New York: Harper & Row, 1985); and J.R. Galbraith, "Designing the Innovating Organization," Organizational Dynamics 10 (winter 1982): 5-25.

[3]The term "contextual ambidexterity" is new, but a number of similar ideas can be found in the literature. See P.S. Adler, B. Goldoftas and D.I. Levine, "Flexibility Versus Efficiency? A Case Study of Model Changeovers in the Toyota Production System," Organization Science 10 (January 1999): 43-68; and S. Ghoshal and C.A. Bartlett, "Linking Organizational Context and Managerial Action: The Dimensions of Quality of Management," Strategic Management Journal 15 (summer 1994): 91-112.

[4]The concept of market orientation emerged in the early 1990s. See B.J. Jaworski and A.K. Kohli, "Market Orientation: Antecedents and Consequences," Journal of Marketing 57 (July 1993): 53-70; and J.C. Narver & S.F. Slater, "The Effect of a Market Orientation on Business Profitability," Journal of Marketing 54 (October 1990): 20-35.

[5]See S. Ghoshal and C.A. Bartlett, "The Individualized Corporation: A Fundamentally New Approach to Management" (New York: Harper Business, 1997).

[6]The term "country-club context" was first used by Robert Blake and Jane Mouton to describe a particular type of individual in their managerial grid. While their work focused on the individual level of analysis, there are strong parallels with our work on contextual ambidexterity. See R.R. Blake and J.S. Mouton, "Corporate Excellence Through Grid Organization Development: A Systems Approach" (Houston: Gulf Publishing Co., 1968).

[7]This example is taken from H. Bruch and S. Ghoshal, "Lufthansa: The Challenge of Globalization," London Business School teaching case, ECCH no. 396-142-1 (Bedfordshire, United Kingdom: European Case Clearing House, 2000).

[8]See A. Campbell, J. Birkinshaw, A. Morrison and R. van Basten Batenburg, "The Future of Corporate Venturing," MIT Sloan Management Review 45 (fall 2003): 30-37.

[9]For additional insights on this approach to leadership, see J. O'Toole, "When Leadership Is an Organizational Trait" in "The Future of Leadership: Today's Top Leadership Thinkers Speak to Tomorrow's Leaders," eds. W. Bennis, G.M. Spreitzer and T.G. Cummings (San Francisco: Jossey-Bass, 2001); B.A. Pasternack and J. O'Toole, "Yellow-Light Leadership: How the World's Best Companies Manage Uncertainty," Strategy+Business 28 (second quarter 2002); and B.A. Pasternack, P.F. Anderson and T.D. Williams, "Leadership as an Institutional Trait," Strategy+Business 26 (second quarter 2000): 11.

Reading 4-3 Matrix Management: Not a Structure, a Frame of Mind

Christopher A. Bartlett and Sumantra Ghoshal

Top-level managers in many of today's leading corporations are losing control of their companies. The problem is not that they have misjudged the demands created by an increasingly complex environment and an accelerating rate of environmental change, nor even that they have failed to develop strategies appropriate to the new challenges. The problem is that their companies are organizationally incapable of carrying out the sophisticated strategies they have developed. Over the past 20 years, strategic thinking has far outdistanced organizational capabilities.

All through the 1980s, companies everywhere were redefining their strategies and reconfiguring their operations in response to such developments as the globalization of markets, the intensification of competition, the acceleration of product life cycles, and the growing complexity of relationships with suppliers, customers, employees, governments, even competitors. But as companies struggled with these changing environmental realities, many fell into one of two traps—one strategic, one structural.

The strategic trap was to implement simple, static solutions to complex and dynamic problems. The bait was often a consultant's siren song promising to simplify or at least minimize complexity and

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discontinuity. Despite the new demands of overlapping industry boundaries and greatly altered value-added chains, managers were promised success if they would "stick to their knitting." In a swiftly changing international political economy, they were urged to rein in dispersed overseas operations and focus on the triad markets, and in an increasingly intricate and sophisticated competitive environment, they were encouraged to choose between alternative generic strategies—low cost or differentiation.

Yet the strategic reality for most companies was that both their business and their environment really *were* more complex, while the proposed solutions were often simple, even simplistic. The traditional telephone company that stuck to its knitting was trampled by competitors who redefined their strategies in response to new technologies linking telecommunications, computers, and office equipment into a single integrated system. The packaged-goods company that concentrated on the triad markets quickly discovered that Europe, Japan, and the United States were the epicenters of global competitive activity, with higher risks and slimmer profits than more protected and less competitive markets such as Australia, Turkey, and Brazil. The consumer electronics company that adopted an either-or generic strategy found itself facing competitors able to develop cost and differentiation capabilities at the same time.

In recent years, as more and more managers recognized oversimplification as a strategic trap, they began to accept the need to manage complexity rather than seek to minimize it. This realization, however, led many into an equally threatening organizational trap when they concluded that the best response to increasingly complex strategic requirements was increasingly complex organizational structures.

The obvious organizational solution to strategies that required multiple, simultaneous management capabilities was the matrix structure that became so fashionable in the late 1970s and the early 1980s. Its parallel reporting relationships acknowledged the diverse, conflicting needs of functional, product, and geographic management groups and provided a formal mechanism for resolving them. Its multiple information channels allowed the organization to capture and analyze external complexity. And its overlapping responsibilities were designed to combat parochialism and build flexibility into the company's response to change.

In practice, however, the matrix proved all but unmanageable—especially in an international context. Dual reporting led to conflict and confusion; the proliferation of channels created informational logjams as a proliferation of committees and reports bogged down the organization; and overlapping responsibilities produced turf battles and a loss of accountability. Separated by barriers of distance, language, time, and culture, managers found it virtually impossible to clarify the confusion and resolve the conflicts.

In hindsight, the strategic and structural traps seem simple enough to avoid, so one has to wonder why so many experienced general managers have fallen into them. Much of the answer lies in the way we have traditionally thought about the general manager's role. For decades, we have seen the general manager as chief strategic guru and principal organizational architect. But as the competitive climate grows less stable and less predictable, it is harder for one person alone to succeed in that great visionary role. Similarly, as formal, hierarchical structure gives way to networks of personal relationships that work through informal, horizontal communication channels, the image of top management in an isolated corner office moving boxes and lines on an organization chart becomes increasingly anachronistic.

Paradoxically, as strategies and organizations become more complex and sophisticated, top-level general managers are beginning to replace their historical concentration on the grand issues of strategy and structure with a focus on the details of managing people and processes. The critical strategic requirement is not to devise the most ingenious and well-coordinated plan but to build the most viable and flexible strategic process; the key organizational task is not to design the most elegant structure but to capture individual capabilities and motivate the entire organization to respond cooperatively to a complicated and dynamic environment.

Building an Organization

Although business thinkers have written a great deal about strategic innovation, they have paid far less attention to the accompanying organizational challenges. Yet many companies remain caught in the structural-complexity trap that paralyzes their ability to respond quickly or flexibly to the new strategic imperatives.

For those companies that adopted matrix structures, the problem was not in the way they defined the goal. They correctly recognized the need for a multi-dimensional organization to respond to growing external complexity. The problem was that they defined their organizational objectives in purely structural terms. Yet the term *formal structure* describes only the organization's basic anatomy. Companies must also concern themselves with organizational physiology—the systems and relationships that allow the lifeblood of information to flow through the organization. They also need to develop a healthy organizational psychology—the shared norms, values, and beliefs that shape the way individual managers think and act.

The companies that fell into the organizational trap assumed that changing their formal structure (anatomy) would force changes in interpersonal relationships and decision processes (physiology), which in turn would reshape the individual attitudes and actions of managers (psychology).

But as many companies have discovered, reconfiguring the formal structure is a blunt and sometimes brutal instrument of change. A new structure creates new and presumably more useful managerial ties, but these can take months and often years to evolve into effective knowledge-generating and decision-making relationships. And because the new job requirements will frustrate, alienate, or simply overwhelm so many managers, changes in individual attitudes and behavior will likely take even longer.

As companies struggle to create organizational capabilities that reflect rather than diminish environmental complexity, good managers gradually stop searching for the ideal structural template to impose on the company from the top down. Instead, they focus on the challenge of building up an appropriate set of employee attitudes and skills and linking them together with carefully developed processes and relationships. In other words, they begin to focus on building the organization rather than simply on installing a new structure.

Indeed, the companies that are most successful at developing multi-dimensional organizations begin at the far end of the anatomy–physiology–psychology sequence. Their first objective is to alter the organizational psychology—the broad corporate beliefs and norms that shape managers' perceptions and actions. Then, by enriching and clarifying communication and decision processes, companies reinforce these psychological changes with improvements in organizational physiology. Only later do they consolidate and confirm their progress by realigning organizational anatomy through changes in the formal structure.

No company we know of has discovered a quick or easy way to change its organizational psychology to reshape the understanding, identification, and commitment of its employees. But we found three principal characteristics common to those that managed the task most effectively:

1. They developed and communicated a clear and consistent corporate vision.
2. They effectively managed human resource tools to broaden individual perspectives and to develop identification with corporate goals.
3. They integrated individual thinking and activities into the broad corporate agenda by a process we call co-option.

Building a Shared Vision

Perhaps the main reason managers in large, complex companies cling to parochial attitudes is that their frame of reference is bounded by their specific responsibilities. The surest way to break down such insularity is to develop and communicate a clear sense of corporate purpose that extends into every corner of the company and gives context and meaning to each manager's particular roles and responsibilities. We are not talking about a slogan, however catchy and pointed. We are talking about a company vision, which must be crafted and articulated with clarity, continuity, and consistency. We are talking about clarity of expression that makes company objectives understandable and meaningful; continuity of purpose that underscores their enduring importance; and consistency of application across business units and geographical boundaries that ensures uniformity throughout the organization.

Clarity There are three keys to clarity in a corporate vision: simplicity, relevance, and reinforcement. NEC's integration of computers and communications—C&C—is probably the best single example of how simplicity can make a vision more powerful. Top management has applied the C&C concept so effectively that it describes the company's business focus, defines its distinctive source of competitive advantage over large companies like IBM and AT&T, and summarizes its strategic and organizational imperatives.

The second key, relevance, means linking broad objectives to concrete agendas. When Wisse Dekker became CEO at Philips, his principal strategic concern was the problem of competing with Japan. He stated this challenge in martial terms—the U.S. had abandoned the battlefield; Philips was now Europe's last defense against insurgent Japanese electronics companies. By focusing the company's attention not only on Philips's corporate survival but also on the protection of national and regional interests, Dekker heightened the sense of urgency and commitment in a way that legitimized cost-cutting efforts, drove an extensive rationalization of plant operations, and inspired a new level of sales achievements.

The third key to clarity is top management's continual reinforcement, elaboration, and interpretation of the core vision to keep it from becoming obsolete or abstract. Founder Konosuke Matsushita developed a grand, 250-year vision for his company, but he also managed to give it immediate relevance. He summed up its overall message in the "Seven Spirits of Matsushita," to which he referred constantly in his policy statements. Each January he wove the company's one-year operational objectives into his overarching concept to produce an annual theme that he then captured in a slogan. For all the loftiness of his concept of corporate purpose, he gave his managers immediate, concrete guidance in implementing Matsushita's goals.

Continuity Despite shifts in leadership and continual adjustments in short-term business priorities, companies must remain committed to the same core set of strategic objectives and organizational values. Without such continuity, unifying vision might as well be expressed in terms of quarterly goals.

It was General Electric's lack of this kind of continuity that led to the erosion of its once formidable position in electrical appliances in many countries. Over a period of 20 years and under successive CEOs, the company's international consumer-product strategy never stayed the same for long. From building locally responsive and self-sufficient "mini-GEs" in each market, the company turned to a policy of developing low-cost offshore sources, which eventually evolved into a de facto strategy of international outsourcing. Finally, following its acquisition of RCA, GE's consumer electronics strategy made another about-face and focused on building centralized scale to defend domestic share. Meanwhile, the product strategy within this shifting business emphasis was itself unstable. The Brazilian subsidiary, for example, built its TV business in the 1960s until it was told to stop; in the early 1970s, it emphasized large appliances until it was denied funding, then it focused on housewares until the parent company sold off that business. In two decades, GE utterly dissipated its dominant franchise in Brazil's electrical products market.

Unilever, by contrast, made an enduring commitment to its Brazilian subsidiary, despite volatile swings in Brazil's business climate. Company chairman Floris Maljers emphasized the importance of looking past the latest political crisis or economic downturn to the long-term business potential. "In those parts of the world," he remarked, "you take your management cues from the way they dance. The samba method of management is two steps forward then one step back." Unilever built—two steps forward and one step back—a profitable $300 million business in a rapidly growing economy with 130 million consumers, while its wallflower competitors never ventured out onto the floor.

Consistency The third task for top management in communicating strategic purpose is to ensure that everyone in the company shares the same vision. The cost of inconsistency can be horrendous. It always produces confusion and, in extreme cases, can lead to total chaos, with different units of the organization pursuing agendas that are mutually debilitating.

Philips is a good example of a company that, for a time, lost its consistency of corporate purpose. As a legacy of its wartime decision to give some overseas units legal autonomy, management had long experienced difficulty persuading North American Philips (NAP) to play a supportive role in the parent company's global strategies. The problem came to a head with the introduction of Philips's technologically first-rate videocassette recording system, the V2000. Despite considerable pressure from world headquarters in the Netherlands, NAP refused to launch the system, arguing that Sony's Beta system and Matsushita's VHS format were too well established and had cost, feature, and system-support advantages Philips couldn't match. Relying on its legal independence and managerial autonomy, NAP management decided instead to source products from its Japanese competitors and market them under its Magnavox brand name. As a result, Philips was unable to build the efficiency and credibility it needed to challenge Japanese dominance of the VCR business.

Most inconsistencies involve differences between what managers of different operating units see as the company's key objectives. Sometimes, however, different corporate leaders transmit different views of overall priorities and purpose. When this stems from poor communication, it can be fixed. When it's a result of fundamental disagreement, the problem is serious indeed, as illustrated by ITT's problems in developing its strategically vital System 12 switching equipment. Continuing differences between the head of the European organization and the company's chief technology officer over the location and philosophy of the development effort led to confusion and conflict throughout the company. The result was disastrous. ITT had difficulty transferring vital technology across its own unit boundaries and so was irreparably late introducing this key product to a rapidly changing global market. These problems eventually led the company to sell off its core telecommunications business to a competitor.

But formulating and communicating a vision—no matter how clear, enduring, and consistent—cannot succeed unless individual employees understand and accept the company's stated goals and objectives. Problems at this level are more often related to receptivity than to communication. The development of individual understanding and acceptance is a challenge for a company's human resource practices.

Developing Human Resources

While top managers universally recognize their responsibility for developing and allocating a company's scarce assets and resources, their focus on finance and technology often overshadows the task of developing the scarcest resource of all—capable managers. But if there is one key to regaining control of companies that operate in fast-changing environments, it is the ability of top management to turn the perceptions, capabilities, and relationships of individual managers into the building blocks of the organization.

One pervasive problem in companies whose leaders lack this ability—or fail to exercise it—is getting managers to see how their specific responsibilities relate to the broad corporate vision. Growing external complexity and strategic sophistication have accelerated the growth of a cadre of specialists who are physically and organizationally isolated from each other, and the task of dealing with their consequent parochialism should not be delegated to the clerical staff that administers salary structures and benefit programs. Top managers inside and outside the human resource function must be leaders in the recruitment, development, and assignment of the company's vital human talent.

Recruitment and Selection The first step in successfully managing complexity is to tap the full range of available talent. It is a serious mistake to permit historical imbalances in the nationality or functional background of the management group to constrain hiring or subsequent promotion. In today's global marketplace, domestically oriented recruiting limits a company's ability to capitalize on its worldwide pool of management skill and biases its decision-making processes.

After decades of routinely appointing managers from its domestic operations to key positions in overseas subsidiaries, Procter & Gamble realized that the practice not only worked against sensitivity to local cultures—a lesson driven home by several marketing failures in Japan—but also greatly under utilized its pool of high-potential non-American managers. (Fortunately, our studies turned up few companies as shortsighted as one that made overseas assignments on the basis of *poor* performance, because foreign markets were assumed to be "not as tough as the domestic environment.")

Not only must companies enlarge the pool of people available for key positions, they must also develop new criteria for choosing those most likely to succeed. Because past success is no longer a sufficient qualification for increasingly subtle, sensitive, and unpredictable senior-level tasks, top management must become involved in a more discriminating selection process. At Matsushita, top management selects candidates for international assignments on the basis of a comprehensive set of personal characteristics, expressed for simplicity in the acronym SMILE: specialty (the needed skill, capability, or knowledge); management ability (particularly motivational ability); international flexibility (willingness to learn and ability to adapt); language facility; and endeavor (vitality, perseverance in the face of difficulty). These attributes are remarkably similar to those targeted by NEC and Philips, where top executives also are involved in the senior-level selection process.

Training and Development Once the appropriate top-level candidates have been identified, the next challenge is to develop their potential. The most successful development efforts have three aims that take them well beyond the skill-building objectives of classic training programs: to inculcate a common vision and shared values; to broaden management perspectives and capabilities; and to develop contacts and shape management relationships.

To build common vision and values, white-collar employees at Matsushita spend a good part of their first six months in what the company calls "cultural and spiritual training." They study the company credo, the "Seven Spirits of Matsushita," and the philosophy of Konosuke Matsushita. Then they learn how to translate these internalized lessons into daily behavior and even operational decisions. Culture-building exercises as intensive as Matsushita's are sometimes dismissed as innate Japanese practices that would not work in other societies, but in fact, Philips has a similar entry-level training practice (called "organization cohesion training"), as does Unilever (called, straight-forwardly, "indoctrination").

The second objective—broadening management perspectives—is essentially a matter of teaching people how to manage complexity instead of merely to make room for it. To reverse a long and unwieldy tradition of running its operations with two- and three-headed management teams of separate technical, commercial, and sometimes administrative specialists, Philips asked its training and development group to de-specialize top management trainees. By supplementing its traditional menu of specialist courses and functional programs with more intensive general management training, Philips was able to begin replacing the ubiquitous teams with single business heads who also appreciated and respected specialist points of view.

The final aim—developing contacts and relationships—is much more than an incidental byproduct of good management development, as the comments of a senior personnel manager at Unilever suggest: "By bringing managers from different countries and businesses together at Four Acres [Unilever's international management-training college], we build contacts and create bonds that we could never achieve by other means. The company spends as much on training as it does on R&D not only because of the direct effect it has on upgrading skills and knowledge but also because it plays a central role in indoctrinating managers into a Unilever club where personal relationships and informal contacts are much more powerful than the formal systems and structures."

Career-Path Management Although recruitment and training are critically important, the most effective companies recognize that the best way to develop new perspectives and thwart parochialism in their managers is through personal experience. By moving selected managers across functions, businesses, and geographic units, a company encourages cross-fertilization of ideas as well as the flexibility and breadth of experience that enable managers to grapple with complexity and come out on top.

Unilever has long been committed to the development of its human resources as a means of attaining durable competitive advantage. As early as the 1930s, the company was recruiting and developing local employees to replace the parent-company managers who had been running most of its overseas subsidiaries. In a practice that came to be known as "-ization," the company committed itself to the Indianization of its Indian company, the Australization of its Australian company, and so on.

Although delighted with the new talent that began working its way up through the organization, management soon realized that by reducing the transfer of parent-company managers abroad, it had diluted the powerful glue that bound diverse organizational groups together and linked dispersed operations. The answer lay in formalizing a second phase of the -ization process. While continuing with Indianization, for example, Unilever added programs aimed at the "Unileverization" of its Indian managers.

In addition to bringing 300 to 400 managers to Four Acres each year, Unilever typically has 100 to 150 of its most promising overseas managers on short- and long-term job assignments at corporate headquarters. This policy not only brings fresh, close-to-the-market perspectives into corporate decision making but also gives the visiting managers a strong sense of Unilever's strategic vision and organizational values. In the words of one of the expatriates in the corporate offices, "The experience initiates you into the Unilever Club and the clear norms, values, and behaviors that distinguish our people—so much so that we really believe we can spot another Unilever manager anywhere in the world."

Furthermore, the company carefully transfers most of these high-potential individuals through a variety of different functional, product, and geographic positions, often rotating every two or three years. Most important, top management tracks about 1,000 of these people—some 5% of Unilever's total management group—who, as they move through the company, forge an informal network of contacts and relationships that is central to Unilever's decision-making and information-exchange processes.

Widening the perspectives and relationships of key managers as Unilever has done is a good way of developing identification with the broader corporate mission. But a broad sense of identity is not enough. To maintain control of its global strategies, Unilever must secure a strong and lasting individual commitment to corporate visions and objectives. In effect, it must co-opt individual energies and ambitions into the service of corporate goals.

Co-Opting Management Efforts

As organizational complexity grows, managers and management groups tend to become so specialized and isolated and to focus so intently on their own immediate operating responsibilities that they are apt to respond parochially to intrusions on their organizational turf, even when the overall corporate interest is at stake. A classic example, described earlier, was the decision by North American Philips's consumer electronics group to reject the parent company's VCR system.

At about the same time, Philips, like many other companies, began experimenting with ways to convert managers' intellectual understanding of the corporate vision—in Philips's case, an almost evangelical determination to defend Western electronics against the Japanese—into a binding personal commitment. Philips concluded that it could co-opt individuals and organizational groups into the broader vision by inviting them to contribute to the corporate agenda and then giving them direct responsibility for implementation.

In the face of intensifying Japanese competition, Philips knew it had to improve coordination in its consumer electronics among its fiercely independent national organizations. In strengthening the central product divisions, however, Philips did not want to deplete the enterprise or commitment of its capable national management teams.

The company met these conflicting needs with two cross-border initiatives. First, it created a top-level World Policy Council for its video business that included key managers from strategic markets—Germany, France, the United Kingdom, the United States, and Japan. Philips knew that its national companies' long history of independence made local managers reluctant to take orders from Dutch headquarters in Eindhoven—often for good reason, because much of the company's best market knowledge and technological expertise resided in its offshore units. Through the council, Philips co-opted their support for company decisions about product policy and manufacturing location.

Second, in a more powerful move, Philips allocated global responsibilities to units that previously had been purely national in focus. Eindhoven gave NAP the leading role in the development of Philips's projection television and asked it to coordinate development and manufacture of all Philips television sets for North America and Asia. The change in the attitude of NAP managers was dramatic.

A senior manager in NAP's consumer electronics business summed up the feelings of U.S. managers: "At last, we are moving out of the dependency relationship with Eindhoven that was so frustrating to us." Co-option had transformed the defensive, territorial attitude of NAP managers into a more collaborative mind-set. They were making important contributions to global corporate strategy instead of looking for ways to subvert it.

In 1987, with much of its TV set production established in Mexico, the president of NAP's consumer electronics group told the press, "It is the commonality of design that makes it possible for us to move production globally. We have splendid cooperation with Philips in Eindhoven." It was a statement no NAP manager would have made a few years earlier, and it perfectly captured how effectively Philips had co-opted previously isolated, even adversarial, managers into the corporate agenda.

The Matrix in the Manager's Mind

Since the end of World War II, corporate strategy has survived several generations of painful transformation and has grown appropriately agile and athletic. Unfortunately, organizational development has not kept pace, and managerial attitudes lag even farther behind. As a result, corporations now commonly design strategies that seem impossible to implement, for the simple reason that no one can effectively implement third-generation strategies through second-generation organizations run by first-generation managers.

Today the most successful companies are those where top executives recognize the need to manage the new environmental and competitive demands by focusing less on the quest for an ideal structure and more on developing the abilities, behavior, and performance of individual managers. Change succeeds only when those assigned to the new transnational and interdependent tasks understand the overall goals and are dedicated to achieving them.

One senior executive put it this way: "The challenge is not so much to build a matrix structure as it is to create a matrix in the minds of our managers." The inbuilt conflict in a matrix structure pulls managers in several directions at once. Developing a matrix of flexible perspectives and relationships within each manager's mind, however, achieves an entirely different result. It lets individuals make the judgments and negotiate the trade-offs that drive the organization toward a shared strategic objective.