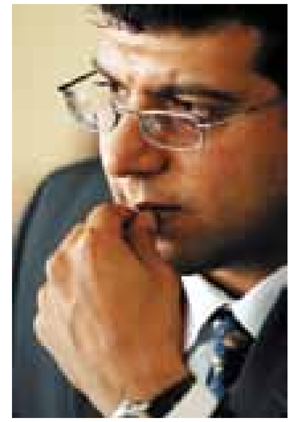
Academy of International Business

# Insights

Vol. 11, No. 1, 2011

## The Evolving Nature of the Multinational Corporation

# The Evolving Nature of the Multinational Corporation



Ilan Alon, *Editor*
Rollins College
ialon@rollins.edu

**GLOBALIZATION HAS GIVEN BIRTH** to the rise of the multinational corporation (MNC). Debates over the merits of globalization often entail an analysis of international companies. Often seen as villains, MNCs have been blamed for the ills of globalization. Liberal economists and some international management scholars, in contrast, have seen the rise of the MNC as part of the natural process of globalization. In this issue, three articles reflect on the changing conditions of the global environment and their implications for the management of MNCs.

The first article in this issue, "Offshoring, Outsourcing, and Strategy in the Global Firm," written by Stephen Tallman of Richmond University, attempts to dispel the hysteria over the recent internationalization of multinational service activities, focusing on what is actually happening as well as the strategic implications. Tallman reminds us of the role of the MNC in generating value, in part, by exploiting comparative advantage. The outsourcing/offshoring of services is merely a recent manifestation enabled by technology. The global firm no longer needs to command and control international activities and, instead, uses its network of value-adding activities, alliances, subsidiaries and affiliates to coordinate the supply chain. The rise of strategic alliances as a mode of entry enables companies to utilize alternative modalities extending beyond the either/or decisions of making or buying. Tallman suggests an innovative model for offshoring/outsourcing that is richer in its conceptualization and takes into account both distances (political, economic, social and technological) and the rent-yielding potential of value-adding activities.

In the second article in the issue, "Corporate Governance and the Multinational Firm," Manzur Rahman of the University of San Diego examines the management of MNCs. Rahman takes a critical view of the Anglo-American model of governance, which gives primacy to shareholders over other stakeholders. This, in part, has led to mismanagement of some multinationals, he claims. Rahman argues that the German model is superior because it is better fitted for the global environment of MNCs characterized by multiple legal jurisdictions, information asymmetry and cross-border inefficiencies.

The third article dovetails with the second by offering prescriptive remedies for MNCs' environmental scanning function. Peter Enderwick of Auckland University of Technology offers his views on the monitoring, identification and evaluation of the international business environments. Environmental scanning has changed in recent years: while information is more abundant, the quality, type, and sources of information are more difficult to evaluate and integrate. Use of environmental scanning techniques, therefore, must change. Enderwick concludes that environmental scanning is critical to the successful management and, ultimately, profitability of MNCs in an increasingly changing world.

Taken together, the three articles in this issue reflect on the changing nature of MNCs and discuss normative implications for IB researchers: (1) Don't be swept by popular outrage against service outsourcing—it is an essential part of globalization borne out of innovations in technology; (2) Evaluate comparative systems of governance and draw judgments on their suitability to the management of the MNC; (3) Revisit established international management concepts, like environmental scanning, and see how they have changed as a result of changing conditions in the global environment.

# Offshoring, Outsourcing, and Strategy in the Global Firm

Stephen Tallman, University of Richmond, United States

**Offshore outsourcing of many** of the activities of the firm has become a major issue of concern in welfare economics, politics, business management, and international business scholarship. From both practical and scholarly perspectives, though, we must recognize that this is not a new phenomenon, and that neither outsourcing nor offshoring is necessarily the problem that has been represented in the popular and scholarly press (Contractor et al., 2010; Engardio, 2006). The production of goods in locations other than those in which they are sold has been an established strategy of multinational firms for decades—as has the subset of situations in which offshore locations are used to produce for home country consumption. "Traditional" situations such as Nike moving shoe manufacturing to Asia have become commonplace and attract little attention. However, the dramatic increase of offshore service provision since 2000 was unexpected, affects the sort of knowledge work that was to be the refuge of the developed world, and imposes international competition on firms, jobs, and markets that had been seen as exempt—and has attracted new attention. In a similar vein, we are finding that offshore outsourcing is expanding rapidly in "new era" sectors such as alternative energy. Even as the science and engineering of alternative energy emerge from Western university labs, companies hoping to exploit these new ideas are finding not only that overseas manufacturing is less expensive but also that only countries like China retain the capacity to manufacture such goods. Perhaps we should take a longer look at offshore outsourcing to see what it can offer us both as scholars and as business practitioners—but without the distractions of populist hysteria.

This article addresses three issues where we international business scholars, collectively, could benefit from cooling down and considering what we already know about international markets and multinational firms rather than pursuing "hot" topics. First, I suggest that by focusing on the narrow issue of producing offshore for the domestic market, whether goods or services, scholars are adding to the overheated, even jingoistic, discussion of the issue and also are losing opportunities to gain theoretical and empirical insights. Second, the general lack of strategic perspective on the topic has put the focus on cost-reduction through location in emerging economies and has led to fears for undifferentiated wholesale relocation of value-production to these countries. Third, convergence on a 2x2 matrix of in-house versus outsourced operations and of on- versus off-shore locations has led to a focus on corner solutions that lock discussion into black-and-white considerations of what is happening as opposed to measured concern for the strategic whys, wheres, and hows.

## The Global Firm and Intra-firm (or Intra-network) Trade

The offshoring discussion focuses on the eventuality that a domestic firm sends some portion of its value-adding activities, whether manufacturing, business processes, or software writing, to another country while continuing to sell its output into the domestic market. This leaves the domestic customer in the position of transferring money to foreign producers rather than to locals, thus draining liquidity out of the domestic economy—or so the story goes. This picture leaves little room for the growing phenomenon of the global firm. Rather, we should consider the overall reliance of global markets on networks of international trade and investment. If a global firm generates value—whether in product design, manufacturing, service support, distribution, marketing, customer service, or any other activity—in multiple differentiated locations around the world (or even within one or more regions of that world), uses intra-firm trade of intermediate goods and services to tie together its operations into an efficient whole, and then sells unique mixes of goods and services in multiple differentiated markets around the world (or region), just what makes the provision of some of these products to the original home market unique?

The reality of international trade and investment is that most flows of capital and goods and services are managed by multinational firms. Indeed, the levels of intra-industry and intra-firm trade and of foreign direct investment traditionally have been used to characterize the global scope of industries and firms (Kobrin, 1991). What is clear in today's marketplace is that better communication technology and increasingly sophisticated views of value-adding activities are allowing global firms to disaggregate or finely slice their activities and to more easily source intermediate goods from the most efficient location—much as Bruce Kogut prescribed in 1985 (Kogut, 1985). Indeed, using comparative advantage, or location-tied superior productivity, as a key basis for competitive advantage, or firm-specific production efficiency, is the great strength of the multinational firm.

*continued on page 4*

*continued from page 3*

Prahalad and Doz's (1987) early characterization of the globally efficient multinational assumes centralized production facilities, but not necessarily home-country production. Bartlett and Ghoshal's discussion of differentiated subsidiary roles in the transnational firm (1989) clearly supposes that subsidiaries in some markets will create significant value that will be incorporated in products sold in others—or at home. Separating value generation from value consumption is a part of the issue, as is the idea of firms sourcing value from multiple locations, as is the reality of many ways of coordinating internationally dispersed, disaggregated value-adding activities. However, such production was never assumed to be only for the home market; rather it is production for a global or regional market. In the case, for instance, of US multinational firms setting up production facilities in a few Western European sites to serve the entire Western European market, the home country is on neither end of the production-consumption equation. Likewise, business services moved abroad as part of the overhead activities of local and regional headquarters, which would be expected to locate service and support activities at their locations.

> "*There is no inherent reason in today's world to assume that strategic leadership comes from the home country . . .*"

Despite all the discussion, offshoring seems to be explained largely by comparative advantage, albeit a sophisticated version in which differentiated inputs are clearly recognized, and communication and governance technologies through which geographically distant operations can be integrated. However, consideration of the developing model of the global firm as a differentiated network of distinct subsidiaries, affiliates, alliances, and contracts all tied together by a small headquarters focused on communication and coordination rather than command and control offers a variety of new directions in organizational economics and management theory. The responses of global firms to the demands of international markets and international sources of products in an increasingly complex global setting offer arrays of strategies and organizations that are changing concepts of management and of organizational and management theory.

## Strategic Purpose and Core Competency

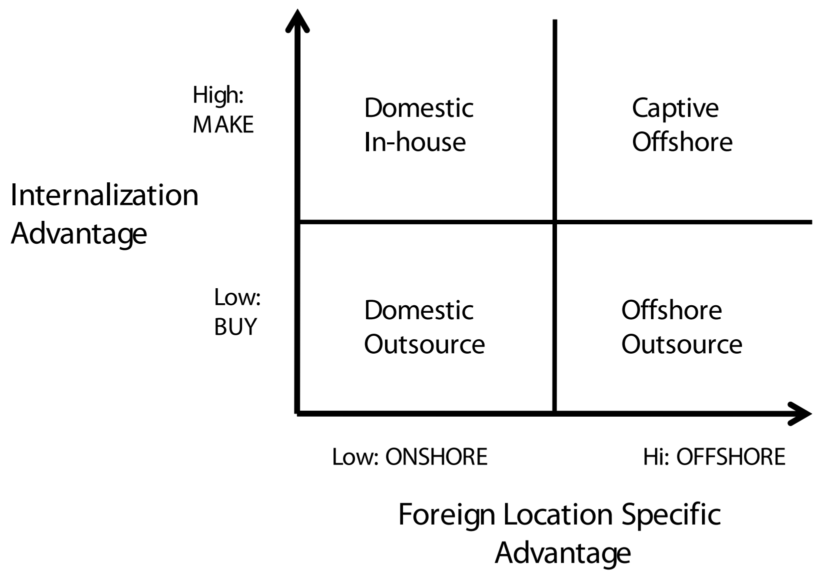
The two-dimensional characterization of offshoring and outsourcing focuses on location and transaction governance, but ignores issues of strategic purposes and capabilities—the discussion is one of outcomes, not of inputs or drivers. Firms are likely to have strong capabilities and stocks of resources in those parts of the value-adding chain that are at their strategic core. In other value-adding steps, any individual firm may have fewer resources or less effective capabilities, and strategic management scholars are largely united in proposing that such activities should be located in other, more competent, firms. The idea that a complete value-adding chain, from idea to final sale, should be internalized within a single economic entity is essentially obsolete—yet discussions of outsourcing seem to treat this as the preferred norm. I find that in overlaying a strategic perspective on the location x governance matrix, an obvious outcome is that core strategies and resources are likely to be kept internal to the firm, while market means, based on price and supplier reliability, are ideal for delivering generic inputs. However, a large proportion of the assets and capabilities deployed by any firm fall between these extremes—they are complementary or co-specialized assets. That is, they will be essential to the firm's ability to actually generate economic rents from its truly unique firm-specific assets, even if the firm does not expect to gain advantage based on these assets themselves. Improvements in IT and contracting and the rise of reliable partner firms from low-cost locations together have made access to such assets through networks of alliances much more likely than in the past.

Strategy is also relevant to the location issue. Comparative advantage is alive and well—not just as a cost minimization consideration, but as a net value-producing process. From a strategic perspective, a core activity may well be kept close to the core location, but twenty years of discussion of transnational strategies suggests that the core for any particular business may not be in the home country—the strategic leader subsidiary is a fact as well as an ideal. There is no inherent reason in today's world to assume that strategic leadership comes from the home country or that the home market is the dominant focus of the firm. Global firms such as Hewlett Packard or DuPont or General Electric do not necessarily headquarter every business in the same country, state, city, or building as the corporate headquarters, and have not done so for some time. A production site with a set of country-specific advantages that offer unique value in combination with the firm-specific resources and capabilities of a particular multinational company could well become a regional or global center for value-added production (Birkinshaw, 2001; Rugman, 1981). Such a site may certainly supply the home market, but perhaps only as a small part of its overall mission.

## Here, There, or Everywhere? A Matter of Distance

My third concern is that even though the focus of the offshoring/outsourcing discussion has been on location factors and transactional governance, analysis of these structural issues is underdeveloped. The presentation of the business process offshoring/outsourcing decision has devolved into a 2x2 matrix, contrasting in/outsourcing with on/offshoring (see Fig. 1). This is certainly a major improvement on the five-year-ago discussion that commonly confused where an activity was happening with who was doing it, but it reflects a disregard for extensive and carefully developed bodies of work on locations and

**Figure 1: The Offshoring/Outsourcing Matrix or "Make/Buy–Here/There"**




internalization. Looking first at the location question, we should see that this simple approach tends to exaggerate both the risks and the benefits of offshoring. A first consideration is that "offshore" as a generic indicator of any and all non-home country locations commoditizes foreign locations—if you are not at home, you are simply offshore. Therefore, if "home" is high on familiarity and low on risk, "away" tends to become the opposite—even if this is not the intent of the original modeler. The "near-shore" construct suggests that this outcome is becoming recognized, but really reduces the issue to geographical distance—suggesting for instance that Canada and Mexico represent similar distances from "home" for a US-based firm. Do we believe this? As every basic international business textbook is at pains to discuss, the economic, cultural, and institutional contexts of international business vary from country to country in varied and complex fashion. At a minimum, this dichotomy should be replaced by a multi-faceted "International Distance" dimension, whether the CAGE model proposed by Ghemawat (2007) or some other version.

At the same time, the benefits of foreign location tend to be exaggerated, so (and again from the US position that is so often assumed) that cost differences, as the most apparent expression of comparative advantage, become the primary, even only, benefit to be set against the uncertainties of the foreign. However, as a variety of scholars have begun to emphasize (Doh et al., 2009), while costs do matter in offshoring, they are never the entire story. So, while place matters, whether seeking an offshore value production platform or foreign market entry, it must be recognized and incorporated into models as a complex and multifarious construct of location specific characteristics and degrees of distance from both home country and market, not a simple "here vs. there" comparison!

## Make-Buy or Make-Ally-Buy?

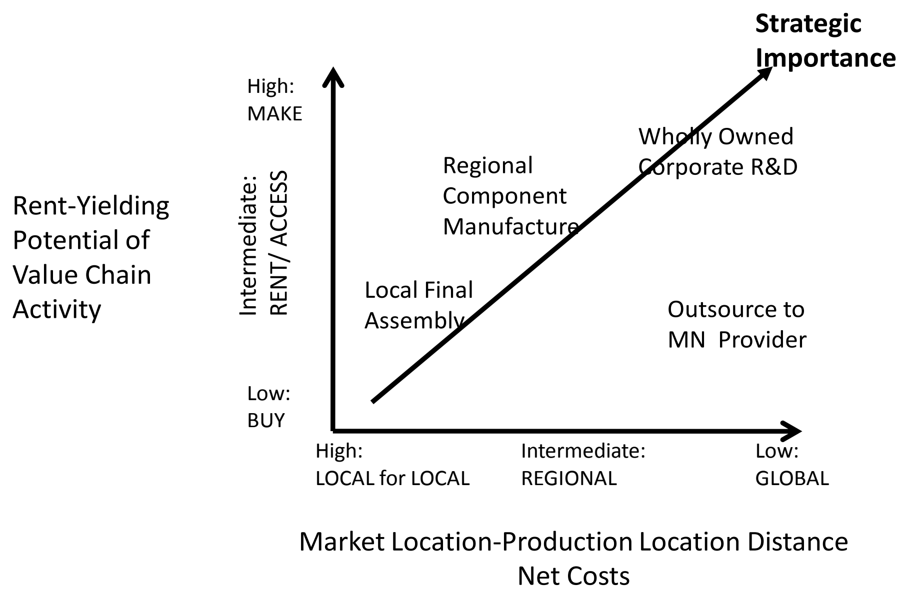
The other side of the location x governance matrix relates to who owns and controls the activity in question. This is typically represented as a "make-buy" decision in which the value-adding activity is either internalized, whether at home or abroad, or outsourced to a supplier in a market transaction. This dichotomy is reminiscent of the early market-hierarchy choice presented in transaction cost economics (Williamson, 1985), though the outsourcing model assumes that an activity is initially pursued inside the company and is moved into the market only when it is less expensive or can be done better by an outsourcing specialist—how it came to be inside the firm is not at issue. The make-buy comparison suggests that outsourcing is done in a market transaction. As such, the transactional costs of markets, particularly from investing in transaction-specific assets, described by Williamson and others, make the outsourcing choice seem particularly high risk. Presuming that the decision has been made to outsource, the focal firm then should minimize its risks by avoiding transaction-specific investments—but this is likely to make the outsourcing transaction inefficient and may risk a poor fit between supplier and client, trading one cost for another.

A generation of work on alliances suggests that the "make-buy" decision is in reality a "make-rent-buy" question, in which access to the services of certain competences can be managed through a wide array of cooperative governance choices. Indeed, in most non-internalized offshoring transactions, the client and the provider engage in a time-extensive, semi-customized, more-or-less flexible relationship that evolves over time—or what is commonly called an alliance, whether an extended contract or an equity joint venture. From a resource-based perspective (Madhok & Tallman, 1998), alliances permit firms to focus on applying their most specialized resources and capabilities, those that offer the greatest potential for generating economic rents, while outsourcing other critical activities to alliance or joint venture partners that special-

*continued on page 6*

*continued from page 5*

**Figure 2: An Alternative Model of Offshoring and Outsourcing**




ize in those areas (see Fig. 2). By investing in transaction and partner specific resources, both sides can consistently improve the efficiency of their complementary sets of assets while making abandonment of the relationship consistently more costly and thereby providing protection from opportunism. How often do real companies actually buy critical services, say payroll administration, in a one-time, arms-length transaction based on price/performance that is re-bid on a frequent basis? Recognition that outsourcing is primarily carried out through alliance transactions changes the risk-return relationships that are expressed in the stark make-buy choice. It also opens up the scholarship relating to outsourcing to influence from the extensive literature on cooperative strategies, particularly international alliances and joint ventures, which addresses in considerable detail most of the governance concerns expressed about outsourcing.

## Offshoring/Outsourcing Is Not New

The effort to treat offshoring/outsourcing as a new or unique strategic action has resulted in its apparent lack of success in developing theory or advancing the study of either internationalization or strategic management beyond observation and simple empirical studies. This same attitude toward the phenomenon limits the potential for scholarship to say much of value to managers—who are already deeply engaged in international sourcing and quickly learning when, where, and how to pursue it in practice. Right now, the literature tells managers who are engaged in deconstructing their firms' value chains and seeking to maximize efficiency and effectiveness through supplier networks and through judicious use of foreign locations that they can gain from accessing comparative advantage in location choice and from considering outsourcing non-critical activities. But they already know those things! If scholars are going to add to the conversation, to provide value to practice, they must do so by connecting current phenomena to much-better-understood historic happenings and concepts. If we can apply what we know about multinational firms and their capabilities and strategies as they interact with the vagaries and challenges of the global economy, we should be able to offer recommendations for action and predictions of performance to practitioners. If we continue to look at offshoring and outsourcing as unique, isolated, modern phenomena, we will end up as catalogers and scolds, but with little to offer either to practice or, in the end, to scholarship.

## References

Bartlett, C. A., & Ghoshal, S. 1989. *Managing across borders: The transnational solution*. Boston: Harvard Business School Press.

Birkinshaw, J. 2001. Strategy and management in MNE subsidiaries. In A. M. Rugman & T. L. Brewer (Eds), *The Oxford handbook of international business*: 380–401. Oxford: Oxford University Press.

Engardio, P. 2006. The future of outsourcing. *BusinessWeek*, January 30: 50–58.

Contractor, F. J., Kumar, V., Kundu, S. K., & Pedersen, T. 2010. Reconceptualizing the firm in a world of outsourcing and offshoring: The organizational geographical relocation of high-value company functions. *Journal of Management Studies*, 47(8): 1417–1433.

Doh, J. P., Bunyaratavej, K., & Hahn, E. D. 2009. Separable but not equal: The location determinants of discrete services offshoring activities. *Journal of International Business Studies*, 40(6): 926–943.

Ghemawat, P. 2007. *Redefining global strategy: Crossing borders in a world where differences still matter*. Boston, MA: Harvard Business School Press.

Kobrin, S. 1991. An empirical analysis of the determinants of global integration. *Strategic Management Journal*, 12(Summer SI): 17–31.

Kogut, B. 1985. Designing global strategies: Comparative and competitive value-added chains. *Sloan Management Review*, 26(4): 15–28.

Madhok, A., & Tallman, S.B. 1998. Resources, transactions, and rents. *Organization Science*, 9(3): 326–339.

Prahalad, C. K., & Doz, Y. 1987. *The multinational mission: Balancing local demands and global vision*. New York: Free Press.

Rugman, A. M. 1981. *Inside the multinationals: The economics of internal markets*. New York: Columbia University Press.

Williamson, O. E. 1985. *The economic institutions of capitalism*. New York: Free Press.

**Stephen Tallman** (Stallman@richmond.edu)is the E. Claiborne Robins Distinguished Professor of Business at the University of Richmond. His research in international strategic management, alliance strategies, knowledge management, and industrial clusters has been published in *Academy of Management Review, Academy of Management Journal, Strategic Management Journal, Organization Science, Journal of International Business Studies,* and other scholarly journals, as well as various chapters and books. He is a founding co-editor of the new *Global Strategy Journal* and an Associate Editor for *Strategic Management Journal.* He is a past chair of the International Management Division of the Academy of Management and the Global Strategy Interest Group of the Strategic Management Society. He is a Fellow of the Academy of International Business.

# Corporate Governance and the Multinational Firm

Manzur Rahman, University of San Diego, United States

**One of the consequences of the** global financial crisis has been a renewed interest in corporate governance—executive compensation schemes, the alignment of incentives and the concomitant impact on firm risk, the role of the board of directors, the distribution of power among management and other stakeholders, etc. have all been subject of vigorous debate in both academic and business circles. For IB researchers this also represents a good opportunity to consider the kind of corporate governance structure that may be most appropriate for firms with multinational operations. Generally, we have shied away from tackling this topic, in no small part due to the fact that it is almost considered a given that a multinational corporation (MNC) would follow the corporate governance system embedded in its home country.

However, the European Union (EU) presents a ready-made laboratory to consider the governance systems of MNCs, especially given that the European Commission considers the coordination and convergence of corporate governance codes across the EU a priority. Typically, most debates on governance systems in the EU lead to contestations over the relative superiority of the two primary contenders, the "Anglo-American" model, which gives primacy to the shareholders, and the "German" model, which emphasizes and distributes power across multiple stakeholder constituencies. But since for the most part empirical studies on cross-country performance difference suggest that "corporate governance systems appear to be equally good, or equally bad, in correcting managerial failure" (Berglof, 2000: 265), such debates have often proved sterile.

In a recent paper, I argue that rather than focusing on the relative efficiency and economic performance of firms under particular governance systems, it might be more fruitful if we were to turn our lens instead to specific aspects of the firms under consideration and the suitability of particular governance structures therein (Rahman, 2009). The core of the argument in that paper—i.e., consideration of the nature of the multinational firm may favor EU-wide adoption of aspects of the German model—is also worth considering in the broader context of the appropriateness of governance structures for MNCs in general. [1]

## Why Is There Shareholder Primacy in the Anglo-American Model?

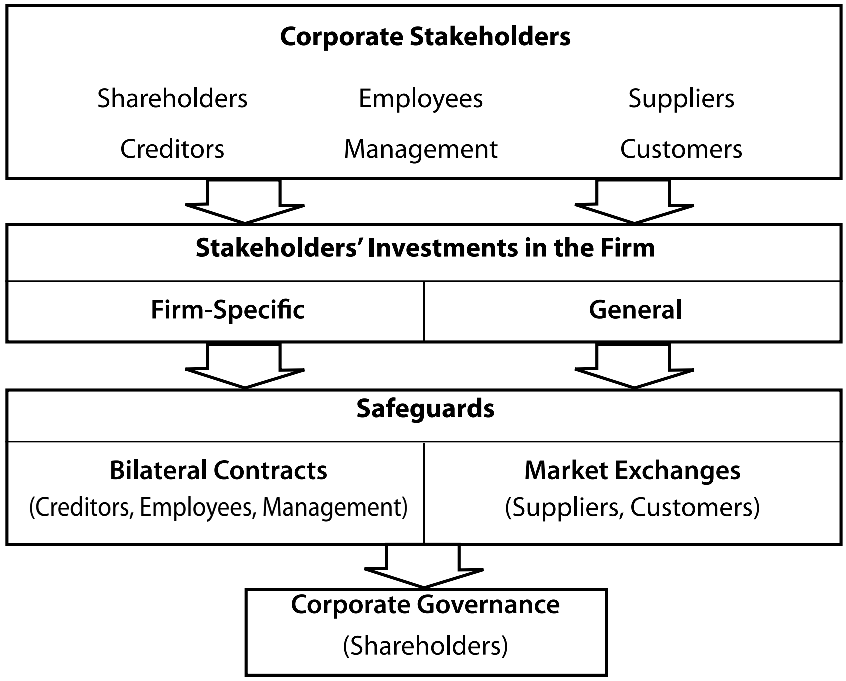
In his seminal paper, "The Nature of the Firm," Coase (1937) penetrates the "black box" of the firm by treating it as a boundary within which exchanges have been internalized rather than occurring at arms-length market transactions; as the market system is suppressed, resources are allocated by authority and direction within the firm. Various individuals—suppliers, employees, shareholders, creditors, etc.—find it more advantageous to contract internally simply because the transaction costs of arms-length dealing would be prohibitive. Thus, corporate governance can be understood to be a system by which firms are directed and controlled.

Williamson's (1984) articulation of the role of corporate governance under a "transaction costs economics" approach provides one of the best rationales for the primacy given to the shareholders in the Anglo-American model. He argues that all stakeholders other than the shareholder can adequately safeguard their investments in the firm through two mechanisms: (1) where the stakeholder's investment in the firm has a readily available market price, he can simply repossess his "collateral" and resell it, and (2) where investment is firm-specific, the stakeholder can usually protect himself by explicitly contracting for bilateral safeguard provisions. In the first category, Williamson places the firm's suppliers and customers who can presumably resell their investments (inventory, product, etc.); in the latter category, he places the firm's employees and creditors who can make customized contracts (wages, severance, collective bargaining, covenants, etc.) to safeguard themselves. Management becomes a rather unique stakeholder constituency since they are the party that contracts with all the others on behalf of the firm, including themselves. Only shareholders, since they are paid after all other claimants have been paid and because their contract with the firm does not come up for periodic renewal, cannot safeguard their fungible, firm-specific investments in the firm by either of the above two mechanisms. As demonstrated in Figure 1, Williamson concludes that only the shareholder needs the corporate governance service of the board of directors to safeguard his interests.

## The Multinational Firm and the Anglo-American Model

Williamson provides a role for corporate governance rooted in the neoclassical model of the firm. Of course, neoclassical economics did not have a good explanation for the existence of MNCs. If we take the internalization theory of MNCs—which is, of course, an extension of Coase's theory of the firm, however now applied to market failures in conducting arms-length transactions across national borders—we can see that just like the situation within the firm, now the market system is suppressed across nations, and resources are again allocated by author-

**Figure 1: Anglo-American Model of Corporate Governance**




Source: Rahman (2009).

ity and direction. However, within MNCs, the authority typically flows only from the parent to the subsidiary. Thus the parent corporation can wield authority to allocate resources across national boundaries, notwithstanding national differences in corporate governance, employment law, supplier-customer practices, etc.

Providing the shareholders a more privileged position requires the belief that the firm's remaining stakeholders can adequately protect their interests by means of bilateral contracts and/or market exchanges. Turning specifically to the question of MNCs, we need to ask whether the conditions necessary for the adequate functioning of those safeguards—as outlined in Figure 2 on next page—are in place in the legal and economic space across which MNCs operate. Here, of course, things become problematic: the raison d'être of an MNC is the suboptimality of market exchanges and contracting due to cross-border market inefficiencies, thereby forcing the firm to internalize economic activity across national borders. Since the MNC operates in jurisdictions that are both quantitatively and, often, qualitatively different in terms of legal practices, rights and responsibilities, reliance on the formation and enforcement of bilateral contracts to protect stakeholder investments will obviously be more difficult, and likely to be less effective. Similarly, as cross-border markets for goods, services, capital and labor are purportedly more inefficient than their uninational counterparts—again, the primary rationale for the existence of MNCs—the various stakeholders would also find that they are less able to rely on market exchanges to protect their investments. Thus, for the various stakeholders of an MNC, a corporate governance framework that provides additional safeguards clearly appears to be more pertinent.

## The Multinational Firm and the German Model

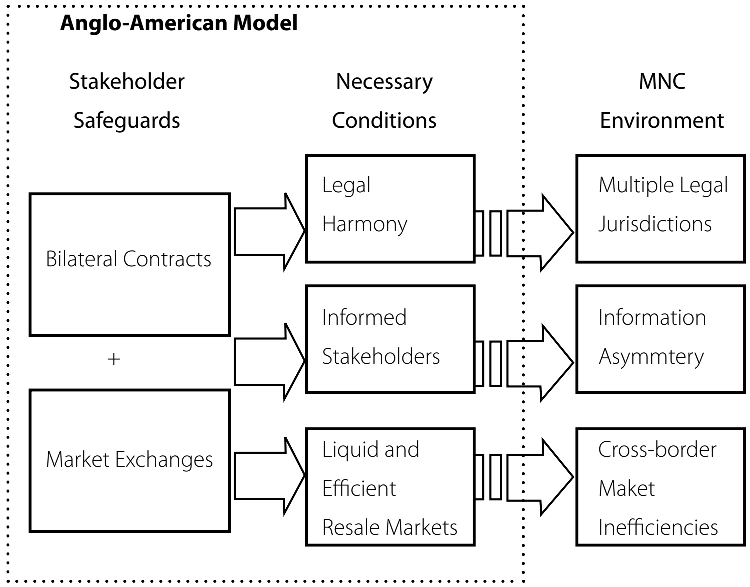
In contrast to the Anglo-American model, the German model of corporate governance requires that the interests of a broader set of stakeholder constituencies be incorporated in the governance regime. Table 1 summarizes the similarities and differences of each model across the various governance mechanisms. German corporate law provides an explicit role for employees in the strategic directions of large corporations (with over two thousand employees): 50% of the supervisory board (Aufsichtsrat)—responsible for selecting and monitoring management and approving major corporate decisions—is made up of employee representatives, with the other 50% being shareholder nominees. The employee members must include management representatives, union representatives, and elected worker representatives, which allows the diversity of the workforce to be reflected as well.

Also in quite sharp relief from the Anglo-American model—with its widely-dispersed shareholder base—the German model includes the presence of large and active shareholders in the supervisory board. To a great extent the shareholder representatives are still largely determined by long-term blockholders—founding family members, the firm's lenders, and important corporate suppliers and customers.

If we consider the legal and economic environment in which the MNC operates to be less amenable to the effective functioning of the safeguards that non-shareholder constituencies are expected to rely upon to protect their investments in the firm under the Anglo-American model, the explicit incorporation of a broader set of stakeholders

*continued on page 10*

**Figure 2: Stakeholder Safeguards and Multinationality**




Source: See Rahman (2009).

*continued from page 9*

under the German model begins to appear more appealing as a suitable corporate governance regime for MNCs. Particularly, the three classes that have the greatest exposure from firm-specific investments—management, employees, and shareholders—all get representation in the board. There has also been widespread concern that management have a disproportionate influence on corporate strategy and often are in a position to expropriate corporate resources for themselves—a recurrent theme in the post-mortems of most corporate failures and scandals, including the most recent one in the financial sector. For MNCs the power imbalance is even more tilted toward management due to the greater incidence of information asymmetry inherent in multinational operations. Thus the countervailing influence of large blockholders—a not infrequent rallying cry in prescriptions of reforming the Anglo-American model—in the German model, often involving an active role by key long-term lenders, suppliers, and customers of the corporation, may be of particular value to the effective governance of MNCs.

## Finding Alternative Models of Governance for the MNC

In the aftermath of the global financial and economic crises, corporate governance is once again very much front and center in debates and discussions on how society regulates and molds the behavior of corporations. Comparative studies on corporate governance models generally fail to reach conclusive agreement on the relative superiority of one model or another based on economic performances that are consistent over time and economic and legal space. In a recent article on the debate over corporate governance in the EU (Rahman, 2009), I follow an "alternative motive at work"—namely, that focusing on the MNC as the referent unit of analysis may allow a means to abstract from the mostly sterile debate on relative efficiency, since the "efficiency based argument on behalf of convergence seems less powerful" (Gordon, 2003: 58). My conclusion in that paper, that consideration of the nature of the MNC suggests the appropriateness of retaining critical elements of the German model of corporate governance within the EU, could be worth extending to the question of governance per se of MNCs in general.

Given that empirical evidence on economic performance across governance systems has been inconclusive and normative approaches often rest on deeply-embedded socio-cultural differences among the analysts, IB researchers for the most part have refrained from attempting to designate an all-encompassing governance regime for MNCs. However, in this essay, I have argued that using the MNC as the referent unit of analysis may provide a more productive avenue for assessing the relative efficacy of particular governance mechanisms, since it allows us to question and evaluate the implicit assumptions at the core of the differences between models that promote shareholder primacy vs. a broader stakeholder approach. More specifically, I find the basic rationale for giving primacy to shareholders particularly tenuous when applied to the governance of firms that span across multiple economic and legal jurisdictions. Corporate governance scholars are, naturally, concerned primarily with the governance of the largest corporations within a society, which, unsurprisingly, tend to be MNCs. Given our interest and knowledge of multinational firms, this is certainly an area where IB researchers can (and should) contribute much more to the debate than has been the case to date.

**Table 1: Corporate Governance Mechanisms: A Comparative View**

| | Anglo-American | German |
|---|---|---|
| Key Stakeholder in Corporate Governance | Shareholder | Shareholders, Employees |
| Board of Directors Elected by: | Shareholders | Employees, Shareholders |
| Board of Directors Structure | Single | Two-Tier |
| Board of Directors: Insider/Outsider Split | Mostly Outsiders | Mostly Insiders |
| Ownership | Diffuse; Non-corporate | Concentrated; High Corporate; Bank; Family |
| Employee Influence on Strategy | Minimal | High |
| Executive Compensation | Very High | Low |
| Takeover Market | Major | Minor |

Source: See Rahman (2009).

## References


Berglöf, E. 2000. Reforming corporate governance: Redirecting the European agenda. In S. S. Cohen & G. Boyd (Eds), *Corporate governance and globalization: Long range planning issues*. Northampton, MA: Edward Elgar.

Coase, R. H. 1937. The nature of the firm. *Economica*, 4(16): 386–405.

Gordon, J. N. 2003. *An international relations perspective on the convergence of corporate governance: German shareholder capitalism and the European Union, 1990–2000*. European Corporate Governance Institute (ECGI) Law Working Paper No. 06/2003.

Rahman, M. 2009. Corporate governance in the European Union: Firm nationality and the 'German' model. *Multinational Business Review*, 17(4): 77–98.

Williamson, O. 1984. Corporate governance. *Yale Law Journal*, 93(7): 1197–1230.


## Endnote

[1] While in the interest of parsimony, I compare and contrast the essential aspects of the Anglo-American and German models in reference to MNCs, the German model's "relationship-based" aspects are shared by and subsumed in Japanese and other East Asian models as well.


**Manzur Rahman** (rahman@sandiego.edu) is a Professor of Finance at the University of San Diego. He has published in the areas of multinational financial policy, corporate governance, corporate finance, and foreign direct investments. Dr. Rahman has bachelor's degrees in Electrical Engineering and Economics from Lafayette College, a juris doctor in Law from the University of San Diego, and a doctorate in Finance and International Business from the University of South Carolina.

# The Imperative of Global Environmental Scanning

Peter Enderwick, Auckland University of Technology, New Zealand

**It is now widely accepted within** the field of management that monitoring of the business environment—environmental scanning (ES) —is elemental to business growth and even survival. This axiom is even more fundamental today when the global business environment offers unprecedented levels of both opportunities and threats. The intention of this brief paper is to explore how ES should be shaped and managed and to identify the key elements of ES practice today. To do this we first define ES and look at why it is so important in business planning. We then compare ES today with its original conception and identify some of the significant changes that have occurred over the past four decades. How to successfully translate ES into improved business practice is then discussed. Given the centrality of ES in the strategic management process, this should be a topic of interest to those involved in both the teaching and practice of international business.

First of all it is important to be clear about what we mean by environmental scanning in a business context. Such scanning involves the identification and evaluation of emerging issues, both opportunities and pitfalls, which affect an organisation's future. The focus of ES is generally the broader environment which influences the organisation, particularly the economic, political, social and technological facets. ES should alert the organisation to the less predictable and controllable elements of change. It provides strategic intelligence that underpins strategic planning.

There are four principal reasons for an organisation to actively engage in environmental scanning to try to identify significant trends in the business environment. The first is simply that the dynamism of the business environment is likely to exceed the agility of most organisations and their management and strategy, resulting in a detrimental misalignment. A very clear recent example of this is provided by the US car industry, which continued to rely on sales of large SUVs at a time when energy prices were at very high levels, credit was drying up, and environmental awareness was increasing sharply. Similar examples include the music and newspaper industries, which were reluctant, or slow, to embrace new technologies, changing consumer expectations, and unanticipated sources of competition.

Second, for almost any organisation the relevant environment is increasingly a global one which necessitates a far broader level of scanning. The marked interdependency of the global business environment means that events in any one part of the world are likely to have secondary effects for many others. The American housing crisis evolved into a global economic crisis, SARs impacted on major cities directly linked to Hong Kong and Southern China, terrorism is a worldwide phenomena, and even natural disasters such as the Iceland volcanic eruption have negatively impacted on producers of perishable products including cut flowers in many parts of the world unable to supply key European markets. Furthermore, in the global era it is important to recognise that competition occurs in more than just final markets for goods and services. The concept of "globality" extends competition into markets for resources, technology and talent (Sirkin et al., 2008). At the same time the sources of new competitors are increasingly difficult to predict: we have world class software firms in India, food processors from Thailand, and new vehicle manufacturers from China.

A third argument for careful monitoring of the business environment is that while there are dangers of being distant from the environment, there are also considerable benefits in achieving a close congruence between environment, strategy and structure. Organisations that can effectively capitalise on the opportunities that exist can benefit considerably. Examples in recent years include Gillette, who managed to restore value to wet shaving systems in the face of strong competition from electric shavers and disposable razors, as well as Apple, who have launched an impressive succession of innovative consumer electronics products to a highly receptive market.

Finally, it is important to recognise that the emerging global business environment has two key characteristics which highlight the need to understand its evolution. The first is unprecedented levels of complexity and competition. It has never been more competitive, while complexity, in part a result of interdependency, is extreme. But at the same time, globalisation has opened up vast new markets, brought millions of new middle class consumers and added significantly to the global labour supply. In essence, business opportunities have never been greater. This suggests the need for firms to prioritise markets and new business ventures. Awareness of comparative developments is a prerequisite for this.

## How Environmental Scanning is Changing

The first systematic discussion of environmental scanning and its integration within the planning process can be traced back to Aguilar (1967), who offered an initial taxonomy of the business environment. However, the nature of the business environment 40 years ago was markedly different from today, so appropriate adaptations in thinking are necessary. A useful way to approach this is shown in Table 1, which offers a contrast of ES over the last four decades or so.

**Table 1: Environmental Scanning: Then and Now**

| *Topic* | *Then* | *Now* |
|---|---|---|
| Amount of information | Limited | Superabundant |
| Nature of sources | Limited, generally known | Unlimited, many unknown |
| Major sources of information | Print media and personal contacts | Vast array of sources and modes |
| Quality of information | Generally quality assured | Massive variation in quality |
| Information challenges | Finding relevant information | Managing information, privacy issues |
| Sources of scanning information | Generally external | Internal and external |
| Scope of information search | Generally restricted, narrow and known areas | Broader and uncertain areas |
| Nature of information search | Passive | Passive and interactive |
| Depth of search | Generally deep | Generally shallow, at least initially |
| Focus of search | Markets, competitors | Broad environment and functions |
| Geographical focus | National and regional | Global to globality |
| Key scanning modes | Conditioned and formal | Undirected and conditioned |
| Balance of ES | Focus | Exploration |
| Successful ES affects | Profitability | Survival |

As the table shows, there have been remarkable changes in a number of aspects of ES. The first, and perhaps the most significant, is the change from a world where information was scarce to one where it is now superabundant. In the digital era information is growing at an annual compound rate of 60 percent, and the amount of digital information increases tenfold every five years (Economist, 2010). A second and related change has been the explosion in the number of potential sources of ES information. While traditionally companies could rely on a finite number of known sources, most of which were in print form or derived from personal contacts, this is no longer the case. There is now a seemingly unlimited supply of information, tangible and intangible, personal and impersonal. Furthermore, there is tremendous variation in the quality of information available. The result of these changes has been in a shift in the challenge of information from locating scarce information to managing information overload.

Table 1 also suggests that the sources of ES information may be changing. Where traditionally information searches may have focused on external sources, today most organisations see virtue in exploiting both external and internal sources. Given the tremendous amount of intellectual capital that exists within many organisations, this combined focus is not surprising. At the same time the scope and nature of information search has changed with a tendency away from a limited range of known sources, to a broader search of unknown areas. While in the past most information consumption was passive, today we see much greater information interaction and a strong growth in machine to machine information exchange and interrogation. These changes have implications for the depth of search. While previously ES focused on deep analysis of known and accepted sources, in today's uncertain world, at least initially, the search is likely to be shallower and broader. This is the result of the greater complexity and uncertainty that exists in the international business environment.

The relevant search focus has also broadened. While earlier studies highlight an emphasis on markets and competitors (Correia & Wilson, 1997; Olsen et al., 1994), contemporary search takes a much broader perspective, elevating the opportunities that exist in the macro-environment (new energy sources, new materials, medical procedures) as well as the new threats (terrorism, new protectionism, global warming, etc). Very few organisations can afford to restrict ES to just their national or regional markets. While these remain relevant and important (Rugman, 2005), a global perspective is increasingly necessary. Furthermore, global competition now encompasses factor, as well as final goods, markets (Sirkin et al., 2008).

The ways in which ES occurs may also have changed. While traditional scanning emphasised conditioned and formal approaches (Aguilar, 1967), contemporary scanning may be better served through a combination of undirected and conditioned modes.

We might also see a future increase in irregular scanning exercise which are ad hoc in nature and often initiated by specific crises (Fahey et al., 1981). This shift reflects a change in the balance of environmental scanning away from a focus on known areas of threats and opportunities to a more exploratory mode of seeking to identify the unknown and the unexpected.

The changes identified in Table 1 are the result of a revision in the way successful ES affects business outcomes. Traditionally, the view was that effective utilisation of ES information contributed to profitability. In

*continued on page 12*

*continued from page 13*
essence, organisations that achieved congruency between their environment, strategy and management systems enjoyed better returns. Nowadays, it is perhaps more realistic to equate successful ES with a higher probability of survival. A failure to anticipate environmental change and disruptive events may well drive an organisation out of existence.

> "*A failure to anticipate environmental change and disruptive events may well drive an organisation out of existence.*"

## How Environmental Scanning Can Improve Business Performance?

The essence of environmental scanning is to enable an organisation to be prepared for, and to respond effectively to, environmental influences. Such organisational learning is fundamental to success. The contribution of ES to organisational success takes a number of forms. It can assist an organisation to capture emerging opportunities, perhaps before competitors. It can also provide early warning of likely future challenges, enabling them to be addressed at a more opportune time. It also sensitises the organisation to the reality of change and the need to adjust to shifting circumstances. Finally, it offers a valuable form of learning and of the need to ensure strategic congruence which contributes to superior performance (Beal, 2000; Chaganti et al., 1989; Olsen et al., 1994; Venkatraman & Prescott, 1990). However, for ES to contribute to organisational performance in a meaningful way, certain conditions must be met.

The first of these is ensuring the appropriate breadth and scope of environmental scanning. There are a number of tradeoffs involved. One is ensuring that ES is sufficiently broad to capture important but unexpected trends, yet is sufficiently focused to be both cost effective and relevant to the organisation's needs. A second trade-off is ensuring a proper balance between the focus and flexibility of ES. While focus contributes to the relevance of information, particularly in the short-term, flexibility facilitates identification of changing circumstances. We can think of the example of IBM, which successfully transformed itself from a computer manufacturer to a business services corporation, and in the future will probably evolve into a knowledge management company. In each of these instances, overemphasis on focus could have suppressed knowledge of the fundamental environmental changes which were driving transformation over incremental improvement. Furthermore, there is evidence that scanning can be constrained by strategic intent (Choo, 1999). That is, pursuit of a particular strategy—cost leadership, product differentiation or focus—strongly influences the form and scope of ES. This could result in strategic inertia as management searches for and utilises information which simply reinforces existing business models.

A second important condition for success in ES is that the function be suitably recognised and supported. This means that management must ensure that sufficient information is captured, that this information is utilised in strategic decision-making, and that the organisation's communication channels are amenable to both the reception and the communication of ES information. The organisation will also have to make effective decisions regarding where the ES function is located within the organisation, how ES information flows are coordinated, and that the level of investment in ES data gathering and analysis is sufficient.

Third, there are a number of barriers to effective environmental scanning that must be overcome. The first is ensuring that ES activities are well managed. The obvious dangers are that important information can be overlooked, that excessive information gathering overwhelms analysts, and that information that is accessed is incomplete or unreliable. At the same time it is important to avoid an undue focus of ES activities on issues that are critical, but also readily discernible (Correia & Wilson, 1997). More generally, it is vital for management to explicitly consider the tensions that arise in ES activities: the tension between control and creativity, between focus and exploration, and between centralisation and decentralisation.

Fourth, reaction to the opportunities and threats thrown up by environmental scanning requires a degree of organisational agility and responsiveness (Sull, 2010). Organisational agility is the capability to identify, exploit and pre-empt emerging opportunities before competitors. In the increasingly turbulent environment that many organisations face, this agility must be tempered with absorption, the ability to withstand rapid change while preparing appropriate strategic initiatives (Amit & Schoemaker, 1993). Clearly, without the ability to respond to environmental change, ES becomes little more than an academic exercise.

The question of exactly how ES should be undertaken, and the primary sources to use, cannot be answered easily. Clearly, it depends critically on the type of business the firm is involved in. The information needs of a clothing business are quite different from those of a pharmaceutical or steel producer. Similarly, diffusion of information becomes as critical as the collection of such information in a large business. Modern electronic sources are invaluable for initial, broad searches while industry specific reports remain indispensable for detailed analysis. The challenge for every business is determining the most effective approach.

## Environmental Scanning is Imperative to the MNC

Environmental scanning has never been more of an imperative than it is today. Effective ES contributes not just to firm profitability, but increasingly to survival. As the table suggests, the nature of ES has changed significantly over the past 40 years. It seems set to continue to change. The future is likely to see companies processing more data, analysing that data in real-time, engaging in data-mining and readily sharing information between different systems, both in-house and with others. New management anxieties will arise. Concerns with data storage, security and privacy are already evident. The transition from information scarcity to overabundance means that the enduring management challenge is likely to be accessing relevant data in an effective way. In this sense, very little has changed.

## References


Aguilar, J. 1967. *Scanning the business environment*. New York: Macmillan.

Amit, R. & Schoemaker, P. J. 1993. Strategic assets and organisational rent. *Strategic Management Journal*, 14(1): 33–46.

Beal, M. R. 2000. Competing effectively: Environmental scanning, competitive strategy, and organizational performance in small manufacturing firms. *Journal of Small Business Management*, 38(1): 27–47.

Chaganti, R., Chaganti, R., & Mahajan V. 1989. Profitable small business strategies under different types of competition. *Entrepreneurship, Theory and Practice*, 13(1): 21–35.

Choo, C. W. 1999. The art of scanning the environment. *Bulletin of the American Society for Information Science*, Feb/March: 21–24.

Correia, Z., & Wilson, T. D. 1997. Scanning the business environment for information: A grounded theory approach. *Information Research*, 2(4): 1–22.

Economist. 2010. All too much: A special report on managing information. *The Economist*, February 25.

Fahey, L., King, W. R., & Narayanan, V. K. 1981. Environmental scanning and forecasting in strategic planning: The state of the art. *Long Range Planning*, 14: 32–39.

Olsen, M. D., Murthy, B., & Teare, R. 1994. CEO perspectives on scanning the global hotel business environment. *International Journal of Contemporary Hospitality Management*. 6(4): 3–9.

Rugman, A. M. 2005. *The regional multinationals: MNEs and "global" strategic management*. Cambridge: Cambridge University Press.

Sirkin, H., Hemerling J., & Bhattacharya, A. 2008. *Globality: Competing with everyone from everywhere for everything*. New York: Business Plus.

Sull, D. 2010. *The upside of turbulence: Seizing the opportunity in an uncertain world*. New York: Harper Business.

Venkatraman, N., & Prescott, J. E. 1990. Environmental-strategy coalignment: An empirical test of its performance implications. *Strategic Management Journal*, 11(1): 1–23.



**Peter Enderwick** (peter.enderwick@aut.ac.nz) is professor of international business at Auckland University of Technology, Auckland, New Zealand. His research interests include multinationals and labor, large emerging markets and management of the international business environment.

# AIB Insights

## Editorial Policy

*AIB Insights* is the Academy of International Business official publication that provides an outlet for short (around 2500 words), interesting, topical, current and thought provoking articles. Articles can discuss theoretical, empirical, practical or pedagogical issues affecting the international business community. The publication seeks articles that have an international business and cross disciplinary orientation with IB researchers and faculty as the intended primary audience.

Authors should highlight the insight of their article in the first paragraph. They should prompt the reader to think about international business and international business teaching/learning in new ways. Articles sought should be grounded in research, but presented in a readable and accessible format.

Articles written for *AIB Insights* should be free of professional jargon and technical terms, light on references, but heavy on insight from the authors' experiences and research. Terminology should be defined if it is not in the common domain of the IB literature. Authors should remember the intended audience of the publication and write accordingly. A regression equation, a correlation matrix, a table or a graph needed to support a point may be included.

*AIB Insights* does not seek the kind of articles that are intended for refereed journals in international business, such as the *Journal of International Business Studies*. The publication is intended to inform, educate and enlighten readers with state of the art information on a topic with a broad appeal to the profession. Acceptable articles may fall into one of several categories:

1. Research insights from authors' stream of research
2. Current issues affecting international business as a discipline
3. The use of technology in international business
4. The International Business department/function/discipline evolving nature
5. Internationalization of the curriculum
6. Innovative approaches to teaching international business
7. Teaching pedagogy and content articles
8. Other topics of interest

Please include a cover page with all the authors' contact details (email, university affiliation, full address, telephone, fax). The second page should include 50-75 word biographies of participating authors. Articles submitted should follow *JIBS* referencing style for consistency.

*AIB Insights* will be published 2-4 times a year with the *AIB Newsletter*. Please send your submission or submission idea to Ilan Alon, Editor (ialon@rollins.edu).

AIB Insights (ISSN: print: 1938-9590; online: 1938-9604) provides an outlet for short, topical, stimulating, and provocative articles. Past copies of the *AIB Insights* can be accessed through the AIB website at http://aib.msu.edu/publications/

AIB Insights is jointly published with the AIB Newsletter by the Academy of International Business Secretariat. For more information, please contact G. Tomas M. Hult, Executive Director or Tunga Kiyak, Managing Director, at:

Academy of International Business
7 Eppley Center
Michigan State University
East Lansing, MI 48824-1121
USA

Tel: +1-517-432-1452
Fax: +1-517-432-1009
Email: aib@aib.msu.edu