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Have You Restructured For Global Success?

By Nirmalya KUMAR & Phanish PURANAM

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Two summers ago, Frits van Paasschen, the CEO of Starwood Hotels, was talking to his wife, Laura, about China. With 70 properties in operation there and 80 more being built, the People's Republic had just become Starwood's second-largest market, after the United States. Van Paasschen jokingly said, "It's almost like we should move our headquarters there." Laura's response, in a nutshell: Perhaps you should.

A year later, van Paasschen did just that—for a month. From June 8 to July 11, 2011, Starwood's eight-member top management team worked out of Shanghai, doing business 12 hours ahead of, rather than behind, the company's official White Plains, New York, headquarters. Starwood now plans to shift its base for a month every year to fast-growing markets such as Brazil, Dubai, and India. The end result of these relocations remains unclear: They may prove to be symbolic, they could be learning moments, or they might portend a permanent move of Starwood's headquarters. Today they epitomize the mounting pressures on multinational companies' organizational structures.

As emerging markets grew explosively in the first decade of the 21st century, multinationals raced to develop new strategies. However, changes in their organizational structures have been slow to follow, and people and processes are coping—but badly. Corporations are trying to shoehorn global operations into existing structures, which is in part why so many are unable to realize the full potential of emerging markets. In fact, 95% of senior executives say that they doubt their companies have the right operating model (of which structure is a key component) for today's world, according to a 2011 Accenture study. Organizational redesigns are complicated and politically messy, however, so responses have ranged from outright denial to grudging acceptance; only a few companies are actually trying to fix the problem.

The pressures on multinational structures seem likely to intensify. Businesses are increasingly seeking not just suppliers and raw materials in emerging markets such as China and India, but also customers. The recent recession has served as a catalyst: Many Western companies believe they have focused too much and for too long on the developed world. Moreover, multinational corporations are scouting for new products and services in developing countries—not just to break into them, but also to kick-start growth at home by offering more value for less money. GE's recent "reverse innovation" success with its MAC 400 and 400i portable electrocardiography machines in India, for example, may seem simple, but most companies struggle to develop such innovations in developing countries or to transplant locally developed innovations worldwide. Such efforts sorely challenge established structures and processes.

At the same time, the nature of innovation is becoming more global because of technological advances. Organizations are figuring out how to break up and distribute, across nations and locations, tightly integrated tasks once performed at only a single site. This global division of R&D facilitates intrafunctional specialization among countries. The advantages include conducting work where the best expertise exists, at the lowest possible cost; exploiting time zone variation to operate 24/7; and mitigating risks by building redundancies across locations. The management dilemmas are, of course, substantial: How do you choose which processes to distribute and where to relocate them? How do you reintegrate them across borders? How do you get people to work effectively across organizational, national, cultural, and time zone barriers?

What's emerging is a new structure, which we call the *T-shaped country organization*. It helps to localize customer-facing operations even as it distributes back-end activities across countries. Showing the way

are companies, such as GE, Intel, and AstraZeneca, that are adapting ideas from the Indian IT-offshoring industry and, in the process, rewriting the way corporations should think about structures.

Why Existing Structures Are Deficient

Figuring out how to manage product lines, regions, and functions has been a perennial problem for multinational companies. Most started out by forming international sales divisions with country-specific subunits at home and by locating only customer-facing (or front-end) processes in each country.

Several companies later adopted transnational structures in order to exploit location-specific advantages in countries far from their home base. Each country's operations specialized in part of the value chain (for instance, Germany focused on product engineering and Mexico on manufacturing) or, sometimes, product lines (Japan developed CT scanners, for example, and Europe X-ray machines).

Other corporations have adopted matrix structures; the axes of the matrix may be products, businesses, functions, or regions. At companies such as ABB and Unilever, managers in an emerging market may have one reporting relationship for product lines and another for functions or regions. One or the other of those relationships tends to dominate in practice, despite their equal importance in theory.

What Kind of Multinational Structure Fits Your Company?

This two-part diagnostic tool can help you calibrate, on scales ranging from 1 to 5, how geographically clustered or dispersed the key capabilities of your businesses are—and gauge whether your organization can collaborate seamlessly across geographies. Plot the two scores on the graph (right) to identify an appropriate global structure for your company.

A. How geographically clustered or dispersed are the skills, capabilities, and resources needed for your businesses to operate?

Highly Clustered: Most are found in one region, often the home region. SCORE 1

Example: Sharp historically has done most of its R&D and manufacturing in Japan. It set up sales units abroad only during the early stages of its international expansion.

Moderately Clustered: Most are found in one region, although different regions may possess advantages for different functions. SCORE 3

Example: Many consumer goods companies today locate manufacturing in Asia, but R&D and product design remain in the U.S.

Highly Distributed: Most are spread across multiple regions. SCORE 5

Example: When GE develops new jet engines, it relies on its China unit to design for manufacture, its India unit for analytics and materials science, and its German labs for wind-tunnel testing.

Score for A: _

B. How competent are people in your organization at working closely across geographies?

Not Very Competent: Effectiveness is confined within specific geographies, functions, and product divisions. SCORE 1

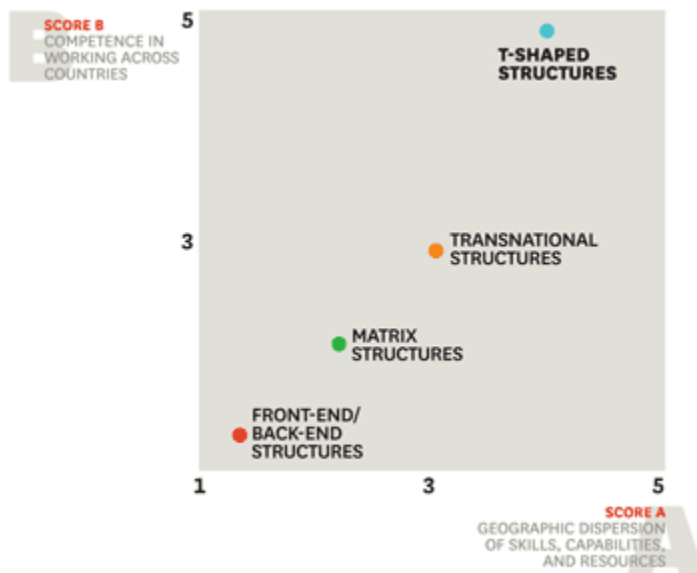
Symptoms: Large technical and cultural differences exist within functions. IT systems don't permit effective collaboration. Resistance to rotating people across countries is strong.

Moderately Competent: People are somewhat effective at working across geographies, functions, and product divisions. SCORE 3

Symptoms: Some but not all of the key ingredients—common language and organizational culture, IT systems that allow remote collaboration, and rotation of employees—are in place.

Highly Competent: People are adept at working across geographies, functions, and product divisions. SCORE 5

Symptoms: Most or all of the key ingredients of collaboration are in place.



A variant involves organizing front-end and back-end operations differently. For instance, in 2001 Cisco created a structure that grouped marketing and sales by customer segment but R&D activities by product line. Between the two, the company set up a solutions group that integrated products into a bundle tailored for each customer. A combination of matrix and back-end integration entails centralizing back-end operations in the home country while managing customer-facing processes via a matrix of product lines and countries. That's how pharmaceutical giants such as Pfizer and tobacco companies such as B.A.T. Industries are organized.

For companies that are keen to tap into the full potential of emerging markets, none of these structures is performing as well as they once did, our research indicates. Three reasons explain the change:

One, the emergence of China and India as leading markets, combined with minimal growth in the developed world, has made the former “stars” and turned the latter into mere “cash cows.” Traditionally perceived as add-ons, whose modified products yielded supplementary revenue, China and India are now major sources of demand, with distinct consumer needs that companies must address. Existing structures don’t facilitate that effort because the balance they strike among products, businesses, functions, and regions is no longer adequate in these two markets.

Two, China and India are becoming sources of talent for developing new products and processes. This trend has resulted in the global segmentation of R&D and in intrafunctional specialization among countries, as mentioned earlier. Corporations can segment R&D vertically into distinct processes that capture customer requirements; generate product specifications; search for technological solutions to meet those specifications; prototype results; and then engineer for manufacture. For instance, Microsoft’s product development team in Hyderabad, India, develops software according to specifications from its U.S. counterparts in Redmond, Washington. That kind of vertical segmentation requires temporal sequencing of each step in the process.

Segmenting R&D horizontally is an alternative technique used to develop multicomponent technologies such as engines, hardware, and advanced software. Organizations design components in parallel in different countries and create interfaces that enable assembly and interoperability. With horizontal segmentation, a unit in China can contribute its design-for-manufacture expertise; one in India can provide analytics and materials science expertise; and another in Germany can chip in with wind-tunnel testing—as happens in GE’s jet engines business.

The shift of innovation activities will likely be self-perpetuating. To perform cutting-edge work, a person must have engaged in less-sophisticated tasks earlier. New entrants work their way up a ladder. You can’t become a partner in a consulting firm without having been an associate, an investment banker without having served as an analyst, or the head of a clinical research team without having worked as a research assistant. In each case, the senior people know exactly what their juniors do because of experience. Without such knowledge, senior managers, arguably, cannot do their jobs effectively or make use of input from juniors.

Geography is fracturing these skill ladders; the lowest rungs for many jobs are now located in developing countries. With those rungs having moved out of the West or having become less remunerative, Western students are less likely to invest in climbing them. The limited availability of talent will, in turn, reinforce the trend of moving the lower rungs of the skill ladder offshore, and so on. To be clear, we are not arguing that Silicon Valley will collapse or that R&D centers in the West are likely to shut down anytime soon. But companies deciding whether to open a new R&D lab in New Jersey or Basel, Switzerland, will increasingly need to justify why they shouldn’t do so in Beijing or Hyderabad, where talent is relatively plentiful and cheaper. The locations multinationals choose for developing their innovation capabilities are likely to change dramatically in the future.

Three, the assumption that multinational corporations’ intellectual leadership should come only from developed markets persists. After all, they used to be the largest and the most profitable markets. Despite the lip service paid to globalization nowadays, estimates suggest that fewer than 15% of *Fortune* Global 500 companies have a CEO from outside their bases. Organizational cultures, too, reflect developed nations’ dominance in intellectual leadership: Think of American creativity at Apple, German reliability at Daimler, Norwegian egalitarianism at Telenor, and so on.

But change is becoming necessary. If China and India turn out to be both a company’s largest markets and its major sources of innovation, something has to give. Few multinationals can escape the

Asianization of their top management teams. As leadership composition changes, the political center of gravity also will shift eastward. Unless corporations adapt to the new loci of innovation and growth, which will change the organizational fabric, they are unlikely to grow as fast as rivals will.

Falling Into the Gaps

These tectonic forces are together opening a set of gaps between multinational companies' ambitions and achievements in emerging markets.

The passion gap.

Multinational companies' subsidiaries in China and India frequently complain about top management's lack of commitment to their markets. Senior executives may pay lip service to growth in China and India, and may visit them frequently, but Asian countries are high-context cultures where executives and investors seek signs that are more tangible than public appearances and pronouncements. Cultural barriers often make local managers suspect that the global leadership isn't excited by foreign markets. They may be right: According to upper echelon theory, the composition of top management teams affects companies' strategic choices. For example, if several senior executives have backgrounds in finance, the company is more likely to rely on M&A. Conversely, the lack of emerging-market experience at the top tends to limit the commitment to developing countries.

The ambition gap.

Most multinational corporations are headquartered in nations whose economies grow today, at most, between 1% and 3% a year. Their CEOs are delighted when overseas subsidiaries deliver double-digit sales growth, but Chinese and Indian entrepreneurs would deem it unacceptable just to reach that threshold. They demand—and invest aggressively to achieve—at least 25% growth year after year. By contrast, Western companies prefer to report revenues and earnings to Wall Street as per their forecasts, which are usually conservative. In addition, many companies refuse to make significant overseas investments simply because short-term profits and management bonuses may suffer.

The value-proposition gap.

Most Chinese and Indian customers are constrained by low incomes and budgets, forcing Western companies to revise their business models and, sometimes, reinvent them completely. Local entrepreneurs, trying to ramp up businesses quickly, are short of capital, too: They often have to pay annual interest rates on borrowings of about 15% (China is an exception), compared with 5% in the developed world. The high cost of capital has led some Indian companies to develop unique business models. For instance, Bharti Airtel outsources IT infrastructure and customer services; buys network capacity instead of equipment; and has merged its infrastructure with that of rivals, thereby limiting the investment required to scale up. Many Western companies find it tough to make inroads against local competitors that have adapted well to these conditions.

The product line gap.

Many transnational giants have not pushed their R&D operations to innovate for the great mass of middle-market consumers in developing countries, or tried to tailor products to local preferences, or even localized their marketing activities. For example, how does BMW's tag line, "The ultimate driving machine," translate in China, where BMWs are usually driven by chauffeurs? How do luxury companies change their product lines from the understated markers of status that are popular in the West to the

“bling” that many emerging-market consumers covet? A few Western companies do develop products exclusively for China and India, but most are content to skim the surface of these markets’ potential.

The Two Strokes of the T-Shaped Structure

Multinational subsidiaries in emerging markets must reorganize themselves so that they can cope better with two sets of pressures. On the customer side, they need to move faster, make more decisions locally, and alter the incentives and career opportunities offered to employees. In other words, their front-end operations must become highly localized. Given the size of emerging markets like China and India, a high level of localization doesn’t preclude economies of scale.

On the back end of the value chain, transnational companies should use emerging markets as platforms for globally segmented innovation, manufacturing, and offshore services. They must break up operations such as product development and R&D, relocate them, possibly across several countries, and integrate them across the world. The issue is no longer simply whether to integrate a subsidiary or give it more autonomy; the answer will depend on whether you’re talking about front-end or back-end processes.

These imperatives demand new responses. Companies must let front-end, or customer-facing, processes in emerging markets enjoy greater autonomy. Back-end processes, particularly product development and R&D, need not be collocated; they could be broken up and integrated across countries to foster global development and manufacturing, not just sharing of ideas. That dual approach yields a T-shaped form: The horizontal stroke represents linkages across countries; the vertical stroke illustrates the need for depth within each country. A T-shaped structure is thus a response to the fact that emerging markets are increasingly becoming lead markets as well as talent pools.

The T-shaped country structure can be seen as an extension of the transnational structure, with one difference: It distributes parts of functions—not entire functions—geographically, which requires unprecedented integration across countries. This differs from the avoidance of duplication across geographies or “nice to have” horizontal exchanges of best practices. Each country unit will have its own area of expertise, and all areas will be necessary for developing new products and services. In each country, the horizontal and vertical strokes of the “T” will be connected loosely. For instance, in India the global R&D centers of companies such as Intel, GE, and Microsoft have a few projects to develop products for local customers, but most of the work supports global product development.

Past research has shown that companies can use two complementary approaches to coordinate processes across geographies: separation and integration. Separation entails isolating the activities in each country and minimizing interactions among countries. Partitioning work in this way allows companies to divide tasks across the globe and exploit local skills. For example, GE’s John F Welch Technology Centre, in Bangalore, embodies GE’s worldwide capability for computational modeling, and AstraZeneca’s unit in Bangalore specializes in tropical medicine. Setting up such centers of expertise means that work can proceed largely independently across locations.

When these spatially distributed pieces of specialist work can’t be completely black-boxed, they must be integrated. One approach involves building formal channels for coordination. These include assigning integration roles (such as that of program manager), locating some employees physically close to others, and opening direct channels of communication to help bridge distances. Ensuring that people speak the same “language” (and that doesn’t mean English) augments the efficacy of these channels. At GE, design engineers from R&D centers around the world collaborate effectively because, as a senior GE Bangalore manager puts it, “We all speak the language of Six Sigma.”

Companies can also use tacit coordination—in other words, without extensive communication—for the same purpose. This relies on shared decision-making procedures, a common vocabulary, and the ability to observe work as it happens across locations. Research has shown that some companies have figured out how to let software engineers in different locations coordinate their iterative programming and bug-fixing activities without communicating in detail. The engineers draw instead on the knowledge they share—which comes from common training and the use of workflow software—to anticipate colleagues’ responses to problems. Even when the engineers had poor substitutes for face-to-face interactions (such as webcams, telephone, and e-mail), they successfully managed cognitive collocation. A senior scientist at AstraZeneca’s Bangalore unit told us, “When people share the same understanding about work procedures, data, methods, and the underlying science, the need to pick up the phone and ask a question doesn’t arise too often.”

The soft factors underlying the mutual understanding shared by geographically dispersed teams have hard consequences, in that they limit the need for travel and prevent coordination failures. Here’s how Guillermo Wille, who used to head GE’s Bangalore R&D campus, summarized the challenge: “People usually don’t trust their counterparts who are sitting 11,000 miles away. If you think about it, though, few companies have the luxury of having all their technologists sitting in one building.... The behavioral reality is that if people are sitting in different buildings, they already pick up the phone or communicate through computers. If you understand that, and have created a culture of treating your teams in the next building or those 11,000 miles away the same, you have it. The only caveat is the time difference, which generates issues in work/life balance. That’s the problem you face.”

Challenges for Top Teams

Amid the focus on structure, it’s easy to forget that leaders are the people who make organizations tick globally. The rise of emerging markets has major implications for how top management teams are configured, where they sit physically, and how they operate culturally.

“Repeopling” the leadership tier.

Multinational companies will increasingly have to move people from emerging markets, especially Chinese and Indian managers, into leadership positions. Companies in financial services, consulting, and technology, where opportunities have migrated quickly to China and India, have been among the first to do so. As a bridging mechanism, companies like P&G rotate non-U.S. executives in and out of headquarters. Many corporations, including P&G and Unilever, have asked the China and India heads to report directly to the worldwide CEO or have accorded them the status of regional heads. Samsung’s China CEO, for instance, is regarded as one of the company’s top three executives worldwide.

Redrawing HQ geography.

Before Asian managers enter the C-suite, Western companies may move closer to China and India. In 2006 McDonald’s located its Asia head to China—its first regional head outside Oak Brook, Illinois. IBM created a growth-markets headquarters in 2008, based in Shanghai and responsible for Asia (non-Japan), Latin America, Russia, Eastern Europe, the Middle East, and Africa. In 2009 HSBC’s then-CEO, Michael Geoghegan, moved from London to Hong Kong to focus on emerging markets, and GM moved the responsibility for global purchasing from Detroit to Shanghai. In 2011 Bayer shifted the base of its general medicines division to Beijing. And GE’s health care unit, the world’s biggest manufacturer of medical-imaging machines, is moving the headquarters of the 115-year-old business from Waukesha, Wisconsin, to Beijing. When Irdeto set up dual headquarters in Hoofddorp, the Netherlands, and in Beijing, the CEO moved to China with his family. In the not-too-distant future, some multinational

companies may toy with the idea of splitting headquarters functions, with compliance staying in the West but intellectual leadership moving to Asia—permanently.

Recognizing cultural shifts.

Not surprisingly, the rise of China and India is leading to discontent among some multinational companies' senior executives who work in developed countries, which still account for most of their profits. However, these markets are growing slowly, competition is intensifying, and profit margins are falling. Besides, as a senior executive at the energy and water company Nalco recently noted, companies often have to dismantle something in mature markets to build elsewhere. Before Western executives start packing their bags for emerging markets, they must realize that expat managers may not always be welcomed: They're expensive, often unable to speak the local language, and lack local networks. On the other hand, expats are likely to be more valued in back-end functions such as R&D and product development, where global segmentation requires intracompany networks and deep technical knowledge.

No organizational design is perfect or permanent. Smart executives recognize that they must make trade-offs that are appropriate to the economic climate, competitive context, and corporate history. The challenge for CEOs is to let the energy, ambition, and optimism they sense in China and India coexist with their developed-market units. Local subsidiaries, frustrated by the shackles that HQ places on them, are increasingly demanding that the worldwide leadership move to emerging markets, defer to them, or get out of the way. Deploying the T-shaped country organization can help companies to walk the tightrope between their operations in developed and rapidly developing countries, to knit people across countries, and to thereby create global competitive advantage.

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