REVIEW ESSAY

TWILIGHT OF THE MULTINATIONAL FIRM?

Alliance Capitalism and Global Business

by John H. Dunning

New York: Routledge, 1997, 383 pp., $75.00 cloth.

The Alliance Revolution: The New Shape of Business Rivalry

by Benjamin Gomes-Casseres

Cambridge, Massachusetts: Harvard University Press, 1996, 305 pp., $36.50 cloth.

The Death of Competition: Leadership and Strategy in the Age of Business Ecosystems

by James F. Moore

New York: Harper Business, 1996, 320 pp., $13.00 paper, $25.00 cloth.

Reviewed by Paul Vaaler

It might seem obvious that the field of international business is concerned with individual firms, particularly multinational firms, and how they compete. Yet the authors of these three works conclude that it is interfirm cooperation, not competition, which characterizes most international business

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The Fletcher Forum of World Affairs, Vol. 22:1, Winter/Spring 1998

transactions. They believe that individual firms serving the same markets with similar products usually avoid competing with each other. The collective actions of firms operating and collaborating in networks, ecosystems or constellations, rather than individual firm rivalries, explain more about who wins and loses in global competition.

Mixed metaphors aside, the ideas in these and other recent works reflect a keen interest among managers, researchers and others in how better to understand and exploit cooperative organizational structures and strategies in the international marketplace. Senior executives seeking to expand their firm's geographic reach opt increasingly for modes of foreign market entry that require partners, often for the long term. They may work cooperatively through a long-term distribution or franchise agreement, or through some form of a joint venture with shared equity ownership. Go-it-alone foreign entry modes, like the wholly-owned subsidiary, are increasingly less popular. Multinational firms are moving cooperatively in packs, and managers as well as researchers want to know more about how and why they do so.

Eclectic Paradigms Old and New

Is the popularity of cooperative structures and strategies really new to international business? John Dunning's compendium of articles in *Alliance Capitalism and Global Business* answers the question affirmatively. Dunning's career as a scholar in the field spans more than four decades and his work follows, and in many cases anticipates, many major research streams. He is perhaps best known for his self-styled "eclectic" paradigm of foreign market entry. Synthesizing ideas from trade and industrial organization economics as well as organizational theory, Dunning argues that a firm's decision to operate in a foreign market is a function of three classes of factors: ownership, location and internalization.

Ownership factors refer to resources within the firm that are sufficiently valuable in a foreign market that they compensate for some of the inherent liabilities of foreignness. One example here may be a patent or a copyright that is held by the firm and recognized by the government of the prospective host country. Locational factors refer to host country attributes that make it attractive to the internationalizing firm. These factors might include low labor costs, well-established rule of law or subsidies from the government for certain manufacturing operations. Internalization factors are a bit less straightforward. They entail resources that reside within the boundaries of the firm but cannot easily be exploited by means of arms-length transactions with other firms. For example, whereas a patent or copyright may be easily valued and sold to others, other resources, such as the multinational firm's culture, cannot be easily valued or transferred. Perhaps the single most important reason for establishing a wholly-owned subsidiary abroad is to provide an organizational structure that is best suited to exploit these difficult-to-value and difficult-to-trade resources.

The central aim of Dunning's *Alliance Capitalism* is to understand how these three types of factors apply when dealing with a network of firms mulling over decisions regarding the organization of international operations. In this new world, individual firm boundaries are fuzzier as their spheres of influence over the way resources may be used is extended to embrace a variety of cooperative arrangements and network agreements. There is no longer a single international network manager, but a coalition of managers seeking to tailor arrangements and agreements among each other in order to take full advantage of ownership, locational and internalization advantages for the system as a whole.

It is tempting to liken Dunning's coordinated networks to other more familiar cooperative systems of alliance capitalism such as the Japanese *keiretsu* or the German main-bank systems.[1] But such a comparison might miss important distinctions. *Keiretsu* or main-bank system firms generally organize themselves around a central financial or manufacturing institution that acts as a hub for information and resource sharing among affiliates. In times of economic stress, the central bank or manufacturer may also serve as a source of capital and provide managerial guidance.

Dunning's network does not necessarily have a central institution orchestrating the work of several firms. It is more akin to a committee of equals that chooses national markets in which to operate, allocates productive activities to individual affiliates or subgroups of affiliates and shares responsibility for the goods and services that issue from this coordinated effort. Such organizations enjoy advantages related to their greater collective size and broader skill sets; but they may have a price to pay. Networks can be slow to act, cumbersome to redirect when the environment changes and given to instability and breakup if the members feel they have been treated unfairly. The effective governance of coordinated networks may make governance issues in the traditional multinational firm seem like child's play. Although Dunning's book contains substantial arguments about why networks exist, he fails to take his argument to the next level and address how to effectively direct them once they are created.

Caring for Others in the Ecosystem

International managers need to have a breadth of experience and flexibility in their outlook. They may be called upon to do such diverse tasks as assessing the efficiency with which an assembly line is running, analyzing the cultural aspects of a prospective advertising campaign and scrutinizing potential host government legislation. In short, international managers play many difficult and diverse roles.

James Moore's *The Death of Competition* would add yet more roles to their repertoire. Right now the international manager thinks and acts merely as the manager of a multinational firm; Moore asks them to take a broader view. They also act as gardeners, foresters and wildlife managers working to shape the futures of the many firms functioning interdependently in an "ecosystem." Moore defines the business ecosystem to which the manager belongs as an economic community supported by interacting organizations and individuals. It produces goods and services of value to customers, who are themselves members of the ecosystem. The member organisms also include suppliers, lead producers, competitors and other stakeholders. Over time, they coevolve their capabilities and roles and tend to align themselves with the directions set by one or more central companies. With the guidance of these central companies, members move toward a shared vision, align their investments and find mutually supportive roles.

Describing an organization in biological terms is not a novel idea. One of the more prominent schools in organizational theory, the population ecology school, argues that most business activity within a broad field can be explained in evolutionary terms. Variant types of an organizational form are created in a business environment, the "fittest" types are then selected, after competition for limited resources, and are retained to propagate the species and improve overall efficiency.[2] Yet Moore's take on the role of biology in organizations is different from the population ecologists. The health of any one firm in *The Death of Competition* depends critically on the health of others in their shared environment. Multinational drug manufacturers, for example, rely on multiple host governments to provide pharmaceutical testing, approval and patent protection. Credit card companies rely on an ecosystem of banks, telecommunications and computing companies to support their financial services. Software vendors rely on each other to adopt certain standard practices in programming new applications. The upshot of all of this collaboration is that adroit firms recognize a broader set of stakeholders in their environment and achieve a position of centrality with respect to them, which in turn nurtures their growth.

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A critical question emerges from the book: does any rivalry exist among Moore's ecosystems? The act of creating a business ecosystem does not, in itself, stave off competition. The very existence of an expanding community of firms in alliance may instead signal others to start making their own similar connections. Research consortia in computer software—Microsoft's DOS versus IBM's OS/2—and media—Sony's Betamax versus Matsushita's VHS—frequently exhibit this sort of sequential grouping around different technological standards. What then follows is often a battle for market share with tremendous losses for one, if not both, of the consortia. Moore's argument glosses over such clashes. He suggests that ecosystems can avoid most direct confrontations with each other by finding an under-served niche in the market. As long as there is still an alternate ecosystem in another's niche, he believes that fighting is not necessarily the norm. The ecosystems will instead quickly figure out that this is a zero-sum game and will tend to accommodate and coevolve by finding ways to get firms in each ecosystem to contribute to the others. Remember this tendency to accommodate and coevolve next time you try to boot-up your computer with OS/2, rent a movie in Betamax format, or book a ticket on Pan Am.

Star Wars

While Dunning's work evokes images of well-engineered network structures and Moore's biological analogies help us to understand the interdependency and fragility of ecosystems, Benjamin Gomes-Casseres utilizes a different lexicon to make his case for the importance of strategic alliances in international business. His *Alliance Revolution* holds that rivalry is increasingly understood in terms of competing constellations of firms. Like Dunning's network, the constellation is a loosely coupled system characterized by coordinated specialization in the production of goods and services, informal contracts governing the behavior of individual members, the absence of any one dominant member and a norm of negotiation and consensus-building before taking collective action.

Yet unlike Dunning, Gomes-Casseres sheds substantial light on how this new entity may overcome its inherent governance problems. The case-study evidence in *Alliance Revolution* suggests that the lack of unity in control within a firm constellation may be mitigated by keeping the overall size of the collective organization down to a workable number and by giving substantial governance authority to one or two firms within the constellation.

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The Mips Computing Systems story is illustrative of both suggestions. Mips began as a Stanford University research project led by three professors who went on to found a company in 1984. Their intention was to commercialize the first microprocessor based on Reduced Instruction Set Computing (RISC) principles. Their approach challenged existing computer designs but would require substantial capital investment and volume production to be successfully commercialized. Mips needed to get big quickly. It did so by licensing RISC technology to over 20 different firms in different branches of the computer industry.

Through this constellation, Mips could recreate many of the organizational advantages enjoyed by larger rivals such as Intel and Motorola. During the late 1980s and early 1990s it enjoyed economies of scale and scope in manufacturing through its Semiconductor Partners—the Mips licensees. Firms within the constellation specialized in certain versions of RISC chip technology and information about the best design and manufacturing processes were shared between members of the group. But the Mips constellation was not without its organizational weaknesses. Decisions about how and when to manufacture new versions of RISC chips were largely decentralized and the subsequent collapse of one constellation partner, ACE, probably arose from Mips' failure to exercise adequate control over the sequencing of certain RISC innovations. The acquisition of Mips by Silicon Graphics in the early 1990s saw the centralization of authority and the successful development of yet another generation of RISC technology to be diffused throughout the constellation.

The constellation idea embodied in Mips and other case studies resembles in some ways an older idea in strategy concerning the importance of sub-industry strategic groups. Starting in the early 1970s economists and management researchers argued that firms within an industry tended to form groupings based on common competitive strategies and performance. When certain firms in an industry—such as the investment banking segment of the financial services industry—consistently outperformed others over time, it was thought to be evidence that strategic groups within the industry had formed. Others in the industry may like to migrate to these more profitable strategic groups, but regulatory barriers to entry, difficult-to-meet standards of service, high capital requirements and/or collaborative behavior by segment incumbents deterred them.[3]

Gomes-Casseres' constellations appear to have many of the attributes that strategic groups possess. Firms are held together by certain commonly held structural factors like common product offering, production technologies, geographical setting or government-mandated policies. Constellations are subject to fragmentation due to changes in the resource make-up of a particular member of the collective or due to changes in the larger collective environment and collaboration becomes more difficult in these circumstances. There is also interconstellation rivalry and the firms often compete by the very means that Moore thinks groups should use to accommodate each other.

Whither the Multinational Firm?

In our discussion of networks, ecosystems and constellations, it might seem that the importance of individual firm strategies has been either permanently lost or at least suppressed for the moment. If this is true, we need to reaffirm the firm's continuing importance in models of strategic behavior and competition. There is no doubt that these larger cooperative structures have a significant impact on the performance of individual firms. Indeed, the performance of an individual business unit is probably influenced by factors at many different levels: macroeconomic factors such as inflation, fiscal and monetary policy and political stability; industry factors such as regulation; sub-industry strategic group factors such as cross-licensing agreements within an industry segment; corporate factors such as accounting practices and portfolio planning processes; and, finally, factors unique to the business-unit or firm.

Networks, ecosystems and constellations represent yet another level to understand and explore. These three books provide guidance on how analyses from this new perspective might be conducted. Personally, I prefer the guidance given by Gomes-Casseres since there are still more factors causing conflict among firms than factors inducing their mutual accommodation, and Gomes-Casseres includes a substantial understanding and exploration of rivalry both within and among these collective organizations.

Maybe the question we should be asking, however, is not whether networks, ecosystems and constellations have an impact on firm performance, but how much of an impact they have. Think about this another way. Pretend you are writing a one-page memorandum to the chief executive of a company which will briefly explain the importance of different types of factors thought to influence company performance. What percentage of the one-page memorandum will be devoted to a discussion of the broad macroeconomic factors affecting firm performance, how much will be devoted to industry-specific or corporate-specific factors, and what percentage would discuss factors unique to the particular firm? A 1991 paper by strategy researcher Richard Rumelt suggests that over two-thirds of the variance in firm performance is related to factors unique to the firm itself and the other third is explained by factors common to firms in the same industry or to firms having the same corporate affiliation.[4]

Such findings show that individual firms still matter substantially when explaining who wins and who loses in international competition. These new cooperative organizational structures may provide supplementary insight, but the action will remain with individual firms. If a firm fails in global competition the fault will not lie in its stars (or its constellation), but in itself.

Notes

1. For a more detailed study of these systems you might turn to Neil Gerlach's book, *Alliance Capitalism: The Social Organization of Japanese Business* (New York: Oxford University Press, 1992).
2. Michael Hannan and Glenn Carroll provide a detailed exposition of the population ecology argument in *Dynamics of Organizational Populations* (New York: Oxford University Press, 1992).
3. A good review of research and findings in the strategic groups tradition is found in a book edited by Michel Ghertman and others, *Statistical Models for Strategic Management* (Boston: Kluewer Academic Publishers, 1997).
4. Richard Rumelt, "How Much Does Industry Matter?" *Strategic Management Journal* 12 (1991): 167-185.