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THE GOLDEN TRIANGLE FOR MNCs:

STANDARDIZATION TOWARDS HEADQUARTERS PRACTICES, STANDARDIZATION TOWARDS GLOBAL BEST PRACTICES AND LOCALIZATION

by

Anne-Wil Harzing & Markus Pudelko

EXECUTIVE SUMMARY

One of the most complex challenges that multinational corporations (MNCs) face is harmonizing the opposing forces of standardization versus localization. Based on a large-scale survey of head-quarters (HQs) and subsidiaries of American, Japanese and German MNCs, we provide evidence that MNCs can no longer afford to define standardization simply as the worldwide adoption of HQ practices. Standardization can take place towards two different poles: HQ practices and global best practices, wherever they originate from. As we believe managing the challenge of localization versus standardization towards either HQ or global best practices is the key to MNC success we call it the Golden Triangle for MNCs. We also argue that it is often standardization towards global best practices that is more relevant than either standardization towards HQ practices or localization. Hence our study supports what have been called geocentric or transnational corporate models, where worldwide learning and knowledge transfer is paramount, regardless of where the knowledge in question originates.

INTRODUCTION

Globalization and MNCs are two closely interlinked phenomena. On the one hand, the growing importance of MNCs is considered to be a key ingredient of the globalization process. On the other hand, MNCs need to become more and more competitive in order to survive in an increasingly globalized world economy. As the importance of MNCs continues to grow, so does the relevance of arguably the most central debate around the management of MNCs: the perpetual conflict between global integration and local responsiveness, or to use another dichotomy, between standardization and localization.

The integration versus responsiveness terminology is most frequently used to characterize MNC strategies in general as, for example, in the seminal contributions of Prahalad & Doz and Bartlett & Ghoshal in the late 1980s. It refers to the level of central coordination by headquarters (HQ) to closely integrate operations worldwide in order to achieve global efficiency through scale and scope economies, versus the influence of subsidiaries in strategic and operational decisions to ensure responsiveness to local conditions in terms of product and strategies. Many Japanese companies – such as Toyota, Canon, and Matsushita – have traditionally emphasized global integration and efficiency, whilst the main proponents of local responsiveness were European companies – such as Unilever, Philips and Nestlé.

Standardization versus localization is the terminology more commonly employed to refer to functional areas such as marketing and human resource management (HRM), the latter being the focus of our attention in this paper. Standardization of MNCs in this context is usually defined as standardization of overseas subsidiaries' management practices towards HQ practices. Global franchises such as McDonalds and Starbucks have standardized both products (though some local variation is allowed) and management practices across the world. In contrast, localization refers to the adoption by overseas subsidiaries of those management practices commonly employed by domestic companies in the respective host countries. Most MNCs will for instance localize promotion and distribution practices, even if they have a global advertising strategy. Since Bartlett & Goshal's seminal work we know that the integration-/responsiveness debate cannot be resolved by declaring one position as more important than the other. To the contrary: in order to remain competitive in a truly globalized world, MNCs are required to integrate these opposite approaches into one overall strategy. Herein then lies the true challenge of the management of MNCs.

Moving to our specific context of HRM, we can observe that in order to more closely integrate company operations worldwide, MNCs attempt to ensure standardized HRM practices by transferring their HQ practices to overseas subsidiaries. As a result, practices at subsidiary level will bear a closer resemblance to practices in the home country than to practices of local firms. American MNCs such as Proctor & Gamble or IBM are usually portrayed as having relatively standardized HRM practices, for instance with regards to recruitment and training. On the other hand, the transfer of HRM practices to overseas subsidiaries is limited by differences in national cultural and institutional characteristics, which might force MNCs to localize their HRM practices. Japanese subsidiaries in the USA such as, for instance, Canon, tend to be much more performance oriented in their incentive structures than their parent companies, ignoring largely the traditional Japanese concept of seniority. German manufacturing subsidiaries in the USA such as BMW or Mercedes tend to cluster in the largely non-unionized South, even though in Germany their parent companies work in close cooperation with the unions. And conversely, American subsidiaries in Germany largely show respect, not only for the regulations, but also for the underlying philosophy of the German concept of codetermination (and if they don't, such as Wal-Mart for example, they frequently suffer from low performance). Given these contradicting demands, the two key questions for MNCs are: how to strike the delicate balance between standardization and localization and which factors determine if a specific management practice should be standardized or localized?

In this paper, we will demonstrate that reality is even more challenging and complex than is usually argued, and show that the classical dichotomy between standardization towards HQ practices and localization is an oversimplification. We claim – and present supporting empirical evidence – that companies are not only confronted with the two opposing challenges of standardization towards HQ practices and localization, but that there is in fact a third factor at play which we call “standardization towards global best practices”. Furthermore, we argue that it is standardization towards global best practices that is often more relevant than either standardization towards HQ practices or localization. Consequently, we argue that the standardization-localization debate requires a major extension as the successful management of MNCs is not about a dual but about a triangular challenge. And since we believe meeting this challenge is the key to MNC success we call it the Golden Triangle for MNCs, or

more specifically the Golden Triangle between standardization towards headquarters practices, standardization towards global best practices and localization.

After briefly outlining the context of our study, our findings will demonstrate that what we call the Golden Triangle for MNCs is not merely a theoretical concept, but already very much a reality in the corporate world. Subsequently, we will outline in more detail that in particular standardization towards global best practices matters. Finally, we specify the circumstances under which MNCs should standardize around HQ practices, localize their HR practices or standardize towards global best practices.

OUR STUDY

Our study's original objective was to investigate whether MNCs from different countries put different emphases on the extent of standardization (towards HQ practices) versus localization (towards host country practices) of the HRM practices of their foreign subsidiaries. For this purpose we studied companies from the same three countries (the USA, Japan and Germany) both at HQ-level in the home country and at subsidiary-level in the two other countries. Through the use of a mail survey directed at high-ranking HR managers (usually at VP level) we collected data from a total of 849 companies from a large variety of industries, in both manufacturing and services. As a result we were able to compare the HRM practices of nine different groups of companies: HQs in the USA, Japan and Germany, subsidiaries of Japanese and German MNCs in the USA, subsidiaries of American and German MNCs in Japan, and subsidiaries of Japanese and American MNCs in Germany. By employing this very carefully matched design, we were able to understand the interplay between standardization and localization to a far greater extent than was possible in previous studies. It was not until we took a close look at our results, however, that we realized that there was in fact another factor at play: standardization towards global best practices. Hence, this paper provides an illumination of the importance of all three aspects of what we have labeled the Golden Triangle for MNCs.

RESULTS

HRM AT HEADQUARTERS: EXPECTED OUTCOME – CLEAR COUNTRY DIFFERENCES

In order to obtain information about the HRM practices at HQ level, we presented our respondents at HQ with a series of pairs of opposing statements concerning HRM practices. For each of these pairs we asked them to classify their own HRM practices on a six-point scale. The pairs of opposing statements covered seven categories, capturing the major elements of HRM. Once aggregated across the three countries, the answers revealed a very clear pattern: the USA, Japan and Germany have distinctly different HRM models and – more specifically – typical American practices were situated close to the poles on the left-hand side of our bipolar scales and typical Japanese practices close to the poles on the right-hand side, while typical German practices were found in-between. Table 1 provides an overview over these findings.

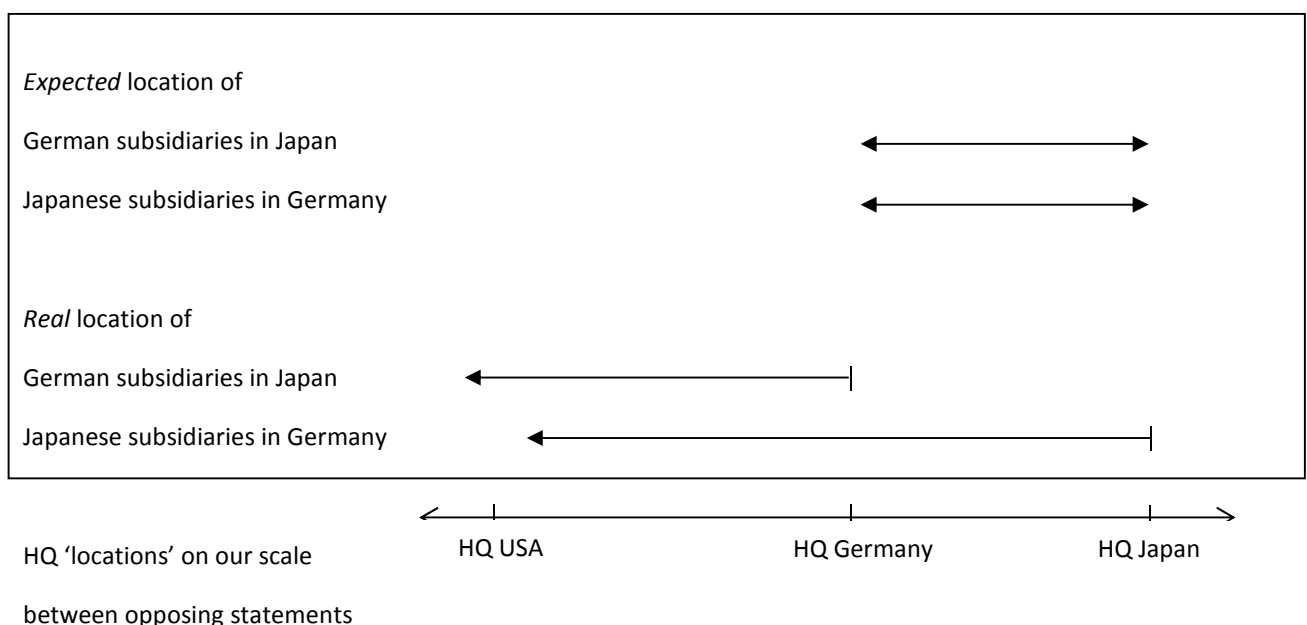
Table 1: HRM at HQ level

USA		GERMANY		JAPAN	
Recruitment and release of personnel					
▪ Job-oriented	In between	▪ People-oriented			
▪ Selection based on performance and expertise		▪ Selection based on inter-personal skills			
▪ High labor turnover		▪ Low labor turnover			
Training and development					
▪ Goal: to create a specialist	In between	▪ Goal: to create a generalist			
▪ Tendency to be limited and focused on the individual		▪ Tendency to be extensive and focused on the work group			
Employee assessment and promotion criteria					
▪ Individual achievements	In between	▪ Seniority and contribution to collective achievements			
▪ Career path confined to one department or area		▪ Career path encompassing several departments and areas			
Employee incentives					
▪ Primarily material incentives	In between	▪ Mix of material and immaterial incentives			
▪ Pay depends on individual performance		▪ Pay depends on seniority			
▪ Very large difference in pay between top-managers and average workers		▪ Little difference in pay between top-managers and average workers			
Communication within the company					
▪ Vertical communication	In between	▪ Horizontal communication			
▪ Brief, highly structured and efficient		▪ Detailed, extensive and harmony enhancing			
Decision making within the company					
▪ Based on hard facts	In between	▪ Based on soft facts			
Superior-subordinate-relationship					
▪ Task-oriented	In between	▪ Person-oriented			
▪ Characterized by regulations		▪ Characterized by common values			
▪ Superior is concerned only with the performance of the subordinate		▪ Superior is also concerned with the well-being of the subordinate			

In total 20 opposing statements were presented to the HR managers. For reasons of clarity Table 1 depicts only those 16 statements in which the dominant pattern (USA and Japan at the opposites, Germany in the middle) became evident. In 13 out of these 16 cases the differences were statistically significant.

The distinctiveness of the three HQ HRM models provided us with an ideal baseline to subsequently investigate HRM practices of the six subsidiary groups and to compare those with the HQ findings. Our assumption was simple: management practices of all six subsidiary groups should be some kind of a combination model of parent and host country practices. However, to our considerable surprise, this assumption turned out to be significantly flawed. Subsidiaries did not necessarily position their HRM practices in between those of parent and host country. This became particularly evident with German subsidiaries in Japan and Japanese subsidiaries in Germany. Figure 1 illustrates this.

Figure 1: HRM of German subsidiaries in Japan and Japanese subsidiaries in Germany



Given our assumption that subsidiaries would follow a combination model, we expected HRM practices of Japanese subsidiaries in Germany (and HRM practices of German subsidiaries in Japan) to be “in between” those of German and Japanese HQ. But in neither case this turned out to be true. HRM practices of Japanese subsidiaries in Germany had no resemblance to Japanese HRM practices (no standardization towards HQ practices), but also did not approximate German HRM practices (no localization). Instead they even “surpassed” the German model in “short-term performance efficiency based on flexible market structures and profit orientation” and aligned themselves much more towards a third country model, that of the USA. With regards to the HRM practices listed in Table 1 this became particularly (but not exclusively) apparent with regards to the following HRM practices: job- (not people-) oriented recruitment criteria, selection mainly based on performance and experience, a higher labor turnover, a more specialized training content and larger pay differences between top management and average workers.

Even more radical was the case of German subsidiaries in Japan. They also chose to distance themselves from their own, German model (no standardization towards HQ practices) and did not adopt Japanese practices which we summarized as “long-term behavioral effectiveness based on cooperative clan structures and growth orientation” (no localization). Instead, and similar to the Japanese subsidiaries in Germany, they apparently decided to follow more American style practices. By doing so their HRM practices “moved into the opposite direction” of their host country, Japan. More specifically, the following HRM practices of German subsidiaries in Japan resembled the American model particularly strongly: job- (not people-) oriented recruitment criteria, a higher labor turnover, more specialized training content, more specialized career paths and larger pay differences between top management and average workers.

Evidently, Japanese subsidiaries in Germany and German subsidiaries in Japan chose HRM practices which cannot simply be explained by the standardization-localization debate as we have known it for the last two decades. We interpret what happened here as follows: MNCs are not convinced that either their own HRM model or that of their subsidiaries’ respective host countries represents the optimal model for their subsidiaries to follow. Instead, they choose to standardize their subsidiaries’ HRM practices around that model which – at least according to their perceptions – corresponds most to the so-called “global best practices” and that is the American model. German and Japanese subsidiaries in the USA also followed the American model, but here we cannot determine with certainty whether this is due to standardization towards perceived global best practices or due to localization efforts. Finally, American subsidiaries in Germany were adapting to a significant extent to German practices (the only case of clear localization), while the HRM practices of American subsidiaries in Japan were half way “in between” those of American and Japanese HQ practices. Here we observe a partial localization but also partial standardization, whereby we can’t determine whether this is standardization towards perceived best practices or standardization towards HQ practices. (All reported results were highly statistically significant.)

To summarize the data so far, we have two cases of evident standardization towards perceived best practices, one case of clear localization and three cases where we can’t be certain whether standardization towards best practices is the determining force. Yet, further data from our study lead us to believe that even in these three ambiguous cases standardization towards best practices plays at least a partial role, and one that is increasing over time.

CURRENT TREND IN JAPANESE AND GERMAN MNCS: STANDARDIZATION TOWARDS AMERICAN HRM PRACTICES

To include a dynamic perspective into our analysis, we asked respondents at subsidiaries to indicate whether their subsidiary’s HRM practices were more similar to parent country practices or to host country practices. This question was repeated three times, referring to the past, the present and the future, respectively. Interestingly, the answers of Japanese and German subsidiaries in the USA indicated that moving from the past, to the present, to the future they were increasingly willing to adopt practices of their host country, the USA. By contrast, American subsidiaries in Japan and Germany were less and less willing to adapt to

their respective host environments. This suggests that Japanese, German and also American companies increasingly see the American model as the model that represents “best practices”.

This finding was also corroborated by additional interviews at subsidiary level. HR managers of Japanese subsidiaries, both in the US and in Germany, confirmed that the Japanese management model was clearly in crisis and that they were looking increasingly for inspirations from the US. Possibly even more revealing was the following observation that came out very strongly in our interviews with Japanese managers in the US: Japanese expatriates who are now in their forties and fifties adapted to a significant degree American manners, perceptions and beliefs. When confronted with this observation in one of our interviews, one interviewee, the president of the New York office of a Japanese MNC jokingly responded: “I’ve a split personality. Of course I behave completely different when I am back in Japan. ... The older generation was different, still being 100 percent Japanese, even while abroad, but the younger ones enjoy having more individual freedom.” This “new openness” might be an important factor explaining why Japanese subsidiaries are embracing “new”, i.e. American practices much more readily than in the past.

German managers also indicated that shortcomings of their own, German, model would become increasingly apparent. German HR managers based at subsidiaries in Japan also mentioned that they have become increasingly disillusioned with Japanese-style HRM. Both Japanese and German subsidiary managers pointed to the increased performance orientation with regards to both promotion and compensation - a feature that has been identified with American-style HRM - as the single most important change in the HRM policies of their subsidiaries. More flexibility in recruitment practices was the second most frequently mentioned change in HRM practices, and again one that is typical for the American model. Finally, American managers, in particular those in Japan, described their declining willingness to follow local practices which they perceive as increasingly dated.

Our study does not claim that the American model is necessarily the best model to follow, but we do suggest that there are good reasons for managers to at least have this perception. Due to the dominant position of American business schools in the development and dissemination of new management knowledge, the dominance of consultancies of American origin such as McKinsey, Boston Consulting and Accenture in further spreading this knowledge and, most importantly, the muscle of the American economy and American MNCs that are known worldwide for their sophisticated management practices such as Procter & Gamble, General Electric and Goldman Sachs, best practices in management are often, explicitly or implicitly, equated with management practices employed by successful American MNCs. This was not always the case. In particular in the 1980s a relative weakness of the American economy coincided with a strong position of not only the Japanese but also German economy. Not surprisingly, in the 1980s best practices were often defined by Japanese management techniques, employed by companies such as Sony, Suntory and Toyota, and, at least in the European context, by German ones, such as Siemens, Daimler Benz and Deutsche Bank. However, in the current situation, the American dominance in defining state of the art management techniques appears undisputed, at least in the perception of most managers.

THE BOTTOM-LINE: “STANDARDIZATION TOWARDS GLOBAL BEST PRACTICES” MATTERS

A review of the strategies followed by MNCs headquartered in different countries clearly shows that standardization towards global best practices matters and that the American model seems to represent those best practices. Our data revealed that HRM practices in subsidiaries of Japanese MNCs are not only strikingly different from traditional Japanese HRM practices but appear to be modeled on American practices. The practical relevance of this finding extends beyond the management of Japanese MNCs. If we find that Japanese MNCs themselves are increasingly moving away from traditional Japanese HRM practices (which seems to be the case not only with companies under foreign influence, such as Nissan with Renault, but even with more traditional and fully independent Japanese companies such as Matsushita and Hitachi), foreign MNCs should not attempt to be “more Japanese than the Japanese” by localizing HRM practices. However, our study shows that American and in particular German subsidiaries in Japan now avoid localizing practices that are increasingly disputed even in Japanese companies. Above we highlighted how various HRM practices, in particular regarding recruitment, training, assessment & promotion and incentives of subsidiaries in Japan become increasingly “Americanized”. However, as Evans et al. observe, there are still many foreign joint ventures in Japan which seem to represent “museums of Japanese management” as they still employ obsolete HRM practices that local Japanese companies have long abandoned.

German subsidiaries also show a clear tendency to follow the American HRM model although – since German HRM practices were already closer to American practices – the change isn’t as striking as for their Japanese counterparts. This change was particularly evident regarding recruitment, training and incentives. Given that American HRM practices are perceived to represent global best practices, it might at first sight appear counter-intuitive that American subsidiaries actually localize their HRM practices to some extent in Japan and even more so in Germany. On the other hand, in contrast to Japanese and German MNCs, American MNCs do demonstrate a certain extent of transfer of their HQ HRM practices, as is evidenced by the fact that HRM practices are only partially localized.

Consequently, we find ample support for the presence of standardization towards best practices. We argue that this finding is of considerable significance since in the current MNC literature the standardization of management practices is mostly associated with standardization towards HQ practices and much less, if at all, by standardization towards best practices. In addition, our result lead to the interesting observation that it is human resource management, a function that is often considered to be one of the most locally embedded of business functions that shows strong signs of converging towards global best practices.

PRACTICAL IMPLICATIONS FOR MNCs: WHEN TO IMPLEMENT WHICH STRATEGY?

As we argued above, MNCs are not only making a choice between standardization towards HQ practices and localization as usually suggested in the literature; they de facto take a third strategy into consideration: standardization towards best practices. If all three strategies need to be considered, the key question that follows is: what determines which strategy

should receive precedence? We suggest two factors here: (internal) core competencies and the (external) environment.

In order to ensure global competitiveness, companies must ensure that whatever they perceive as their core competencies will become standard practice throughout the entire organization, as these core competencies are the key to corporate success. Without possessing unique corporate competencies a company can only imitate what others already do well. In a highly competitive global market this is an unsustainable position for long-term survival. Consequently, wherever core competencies are at stake, standardization towards HQ practices should prevail. But the definition of what the core competencies of an organization are should be very selective (limited to the “core” of its competencies) and it would be a complete misinterpretation of this concept to assume that everything a company does or even does well belongs to its core competencies.

Whenever core competencies are not involved (and as we just have argued this is by definition the case with most activities) and when in addition subsidiaries have good reason to adapt to specific local cultural and/or institutional circumstances in order to be successful in the environment they are operating in, subsidiaries should be permitted to localize their management practices. Our findings suggest, however, that the need to localize might be less encompassing than is frequently assumed. After all, the subsidiaries in our study saw little need to localize practices, even for HRM, one of the management areas that is most often associated with localization.

Ultimately, in all other cases, that is whenever corporate core competencies are not at stake or there is no real need to localize practices, MNCs should strive for standardization towards global best practices. We are not arguing that standardization towards global best practices is more important than the other two strategies. However, we maintain that it is probably the most suitable strategy in the majority of cases. Standardization towards HQ practices and localization are only applicable in exceptions – exceptions that can make all the difference, but exceptions all the same. In our study, HR managers from Japan, Germany and the USA apparently identified best practices in HRM mostly with American practices. Of course, best practices could in principle derive from any country model (including the parent country) or be a combination of various models. In addition, for different areas of management, different country models might be the point of reference for defining best practices.

Our findings indicated that Japanese and German subsidiaries are aligning their HRM practices towards the American model in particular with regards to all aspects that we covered in the area of recruitment (job-oriented recruitment, selection based on performance and high labor turnover), larger pay differences between top managers and average workers and an increased performance orientation with respect to pay and promotion. Consequently, the more immediate focus on performance appears to be a global “best practice” that increasingly is accepted beyond the US. This finding has considerable practical implications for subsidiary managers.

Furthermore, as a result of the intensification of global competition, companies are less and less able to implement HQ practices on a global level just because the organization “grew up” with them. We argue that organizational heritage (“that’s the way we do things around here”) is still far too often the reason for standardization towards HQ practices. The focus in the management literature on HQ as the most relevant pole around which to standardize

management practices is only reinforcing this practice. Equally, reference towards the “unique” circumstances in a specific host country environment might be used too frequently as an excuse by (local) managers of foreign subsidiaries to follow local practices. In this case societal heritage might needlessly block managerial innovations.

As it is likely that a globally operating company will have a foreign subsidiary in the country where best practices can be found, reverse knowledge transfer becomes more and more important. Local subsidiaries can best understand how to implement those practices and this knowledge needs to be passed on to HQ. In most cases it will be up to HQ to ensure that this knowledge permeates the entire organization, including both HQ itself and foreign subsidiaries in third countries.

CONCLUSION

As we have demonstrated, our study has significant practical and theoretical implications. MNCs will continue to be confronted with the key challenge of achieving a delicate balance between standardizing and localizing management practices. However, they can no longer afford to define standardization simply as worldwide adoption of HQ practices. Furthermore, MNCs should be wary not to localize management practices that local companies themselves increasingly regard as obsolete. From a theoretical perspective, our study has shown that the standardization-localization debate requires a major extension as standardization can take place towards two different poles: towards HQ and towards global best practices, wherever they originate from. Additionally, our findings can be seen as a clear warning that ethnocentric approaches to management are no longer sustainable in today’s globalized corporate environment. Instead, our data seem to support what have been called geocentric or transnational corporate models, where worldwide learning and knowledge transfer is paramount, regardless of where the knowledge in question originates.

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