What is the role of regional headquarters in coordinating international service operations?

SHORT ABSTRACT

Compared to manufacturing firms, service firms tend to select more often regional structures to carry out their strategies. This study sheds light on the relatively uncharted phenomenon of regional structures in coordinating services across borders. With the help of case analysis of four German manufacturing firms with servitization strategies, we will better understand which tasks corporate headquarters delegate to regional units (headquarters or other units) and why they choose to do so. This will also help us define how servitization strategy may drive and influence the available design options for running service operations on a global basis in an MNC, and what type of headquarters structures will support those operations.

INTRODUCTION

Large multinational and multi-divisional corporations carry out an increasing share of the economic activity in the world. Consequently, they have gained significant scholarly attention in the fields of strategic management, international business and organization studies. However, in much of the early work the multinational corporation (MNC) is often equaled with the manufacturing firm, typically managing global supply chains with production in one location and exporting them to a number of other locations. This tradition has led to an oversight, perhaps unintendedly, of service multinationals and the way in which they are organized internationally.

A recent trend in multidivisional corporations is the increasing strategic importance of service components in product offerings, a service-oriented way of value creation, or what has been referred to as 'servitization' (Vandermerve and Rada, 1988; Baines and Lightfoot, 2009). Many manufacturing firms develop hybrid products as part of solutions-based business (Davies et al., 2007; Gebauer et al., 2010; Freiling & Dressel, 2014). Service solutions imply customer integration in the supplier's value-adding process and close interaction between both parties (Freiling, 2012) so that value co-creation can occur (Ramírez, 1999). These service-based interaction and integration processes often imply physical proximity and access to the customer's location. A key stream within service research is 'service dominant logic' (SDL) which argues that distinguishing between goods and services is not necessary anymore; instead, goods and services should be seen as representing interdependent components of value added in a specific context (Vargo and Lusch, 2004). However, MNCs may not be well prepared for designing their operations to meet the new requirements of servitization because the SDL approach differs in significant ways from production and distribution of traditional goods.

Previous research suggests that compared to manufacturing firms, service firms tend to select more often regional structures to carry out their strategies. The work by Rugman (2005) and Rugman and Verbeke (2009) shows that almost half of the top 25 home region-based companies they studied represented various service industries. This reflects the more general trend of the growing service sector in developed economies.

Research on regional organizations – including regional headquarters (RHQ) and regional management mandates – has taken important steps in the recent years (e.g. Ambos & Schlegelmilch, 2010; Piekkari, Nell & Ghauri, 2010; Alfoldi, Clegg & McGaughey, 2011). The field has advanced from its phenomenological origins (e.g. Daniels 1986) first to build typologies of RHQ (Lasserre,

1996; Schütte, 1997; Enright, 2005) to theorizing about the underlying causes and consequences of organizing regionally (Li et al., 2010; Laudien & Freiling, 2011; Lunnan & Zhao, 2013). However, so far this growing stream of research has not considered the specificities of service MNCs (for exceptions, see Ho, 1998; Poon and Thompson, 2003; Enright, 2005) nor the servitized manufacturing MNCs.

Our study explores how and why service MNCs and servitized manufacturing MNCs use regional headquarters to manage their international service operations. More specifically, we address two research questions:

Q1. How do corporations structure and organize their service operations regionally and locally?

Q2. What role do regional headquarters play in supporting service coordination?

We will focus our investigation on industrial services, since the servitization phenomenon is most relevant in this type of business. The customer is another (international) corporation rather than a private individual.

Our empirical analysis will cover four case firms from Germany. This country is known for their internationally strong industrial service firms which are going through an evolution from pure manufacturing firms to providers of services and hybrid solutions. We will apply the case methodology due to the exploratory nature of our investigation. Moreover, since we address a complex phenomenon, the qualities of the case study fit particularly well (Piekkari and Welch, 2011).

This study will contribute to the existing body of knowledge on organization design and the role of headquarters in MNCs in a number of ways. First, it will shed light on the relatively uncharted phenomenon of regional structures in coordinating services across borders. Second, this study will make a specific contribution to research on headquarters as we will better understand which tasks corporate headquarters delegates to regional units (headquarters or other units) and why they choose to do so. This will also help us define how servitization strategy may drive and influence the available design options for running service operations on a global basis in an MNC.

The [full] paper will be structured as follows. The two key streams of literature - regional organizations and the functions regional headquarters are assigned, and the servitization phenomenon - are first introduced and discussed. Thereafter, we will detail our case study of four MNCs, the data collection and analysis process. In the findings, we contrast and compare the use of regional structures in service provision and coordination. The paper ends with some managerial implications and concluding comments.

LITERATURE REVIEW

Regional organizations and regional headquarters Regional units, as focused in this research endeavor, are intermediate organizational units with a mandated role, geographic scope and location (Kähäri, 2014). They are concerned with, and involved in, the control, coordination or integration of activities of one or more subsidiaries in their mandated region (Schütte, 1996; Piekkari et al., 2010). They may also add value through entrepreneurial activities (Kähäri, 2014). Depending on the size and complexity of the corporation, different types of regional units co-exist in reality, e.g. regional headquarters (administrative units that are hierarchically integrated between the headquarters and

the local subsidiaries and assume by order of the headquarters responsibility for activities of local subsidiaries on a regional, function oriented, product oriented or customer oriented basis, cf. Freiling and Laudien, 2010), or regional management mandates (delegation of headquarters functions to local operating subsidiaries, Alfoldi, 2012). Regional organization may also take different shapes. Ambos and Schlegelmilch (2010) provided four alternative structural solutions (a single country market approach, where the RHQ acts as a "central hub", a sub-regional approach with subordinate country clusters, a mix of the two above, and a virtual network, where the responsibilities are shared) and argued that the choice in each MNC will be driven by their firm-specific needs. The full paper will continue with a more detailed discussion on the relevant findings of the extant RHQ research.

Servitization In order to address how service operations are organized in corporations, we need to outline the nature of (industrial) services in more detail. Services are customized offerings that respond to specific customer problems. This 'solution providing' (Davies et al., 2007; Gebauer et al., 2010) includes a sound analysis and evaluation of the needs of a particular customer. It is usually necessary to gather and use the expertise from a variety of firm functions to address the customer needs – and to learn from troubleshooting company-wide.

For accumulating and using expertise, different options are available to turn the wheel of knowledge transfer and learning, such as (Almeida et al., 2002; Ardichvili et al., 2006; Birkinshaw and Hood, 1998; Dhanaraj et al., 2004; Foss and Pedersen, 2002 & 2004; Gupta and Govindarajan, 2000; Hansen, 2002): (1) involving experts of the corporate headquarters, (2) involving experts from other regions – in particular in cases of stronger regional competences of the company, (3) problem oriented communities (e.g. 'self-organizing' communities of practice), (4) local external partners, often certified, or (5) local units of the company that transfer knowledge – e.g. in the event of troubleshooting. A main task within this operation is to store the newly developed knowledge within organizational data carriers and to make it available to future coordination challenges. International service provision goes along with the vast coordination expenditures at local, central, and maybe even at regional levels. In the full paper we will continue exploring the received research on servitization and hybrid solutions.

DATA AND METHOD

Data collection For the purpose of this study, we selected four MNCs that are manufacturers of machines, tools, and similar technical equipment. Firms in this field typically serve niche markets and therefore they have had to internationalize early (particularly those headquartered in European markets). Due to considerable international experience these firms have established international service networks. They also have a servitization strategy in place which was developed either voluntarily or as a response to customer requirements.

The case studies were conducted on firms originating from Germany, a leading origin country for internationally operating manufacturing firms with emerging servitization strategies. They belong to the SME sector or are family businesses. We negotiated access to four companies fulfilling our criteria:

- "Gear GmbH" (pilot case). A manufacturer of gear motors.
- "Medical AG". A manufacturer of medical instruments and material.
- "Laser KG". A manufacturer focused on laser technology and related tools and systems.
- "Molding KG". A manufacturer of molding machines.

We conducted personal semi-structured interviews in each case company. The first part of the interview was non-structured (narrative section), while the latter part followed more tightly a pre-determined script. The narrative section was of utmost importance to collect background information and data on unanticipated issues that contributed to a better understanding of the subject matter at hand. The interview questions were developed both based on prior research as well on emerging research findings from the field.

In every case company, we gathered data both from the regional and local units as well as from the corporate center. For triangulation purposes, the interview data were complemented with information from secondary sources such as the Internet and company documents.

Data analysis The fully transcribed interviews and secondary data formed the foundation for data analysis within and across cases. The data were coded and categorized based on insights from prior research as well as from the empirical data. After various rounds of coding, patterns of relationships between the categories and the conceptual frame are developed. The full paper will provide a more comprehensive description of the case companies and discussion on the application of the case method.

CASE ANALYSIS

We observe different ways how the case companies structure and organize their service operations and utilize regional headquarters.

Preference for low hierarchy and direct reporting Two of our case firms seem to prefer low hierarchy in their global service networks. They see that this approach will reduce complexity in international coordination of network activities, providing clear and short communication channels. Laser KG and Molding KG are companies which prefer this approach. "*We have only one subsidiary in each country and they report directly to the corporate headquarters*" (Molding KG). "*Complexity in administration increases the more cutting surfaces you have*" (Laser KG). In both of these case corporations the service networks are organized with only two hierarchy levels: local service subsidiaries and the corporate headquarters.

Preference for regional support and coordination A contradicting approach has been selected by the other two case firms, Medical AG and Gear GmbH which use regional units (regional headquarters) as a hierarchy level between their corporate headquarters and local service subsidiaries. "*For me they are a real added value for our corporation, a distinguishing feature, well as a part of our value proposition*" (Gear GmbH). Regional headquarters have the advantage of being closer to local subsidiaries than the corporate headquarters, which makes coordination easier. "*There is the clear advantage of geographical proximity*" (Medical AG). The regional headquarters have been delegated some of the functions of the corporate headquarters: "*The regional function is more or less the extended arm of the central function […]"* (Medical AG). They are used as regional coordination hubs and helpdesks for service delivery, knowledge transfer, monitoring activities and have the basic task to look out for regional synergistic effects. "*But if it´s possible to solve the problem with a regional headquarters it is good and we will do it with a regional headquarters*" (Gear GmbH). Furthermore, regional headquarters help to solve language and cultural problems between the corporate headquarters and the local service subsidiaries. "*Yes, it is necessary, because you have language and cultural problems*" (Medical AG).

These findings indicate an interesting contradiction between the two structural solutions applied by our case firms to the management tasks that at the outset seem similar. Considering the somewhat

homogenous background of the case firms, one would expect them to apply more coherent solutions. In the further analysis that will be presented in the full paper, we will dive deeper into the reasons behind these contradictory results, will elaborate on our findings and present a complete analytical review of the cases addressing the two research questions.

REFERENCES

Alfoldi, E.A., Clegg, L.J. and McGaughey, S.L. (2012). Coordination at the Edge of the Empire: The Delegation of Headquarters Functions through Regional Management Mandates. *Journal of International Management*, 18: 276-292.

Almeida, P., Song J. and Grant, R. M. (2002). Are Firms Superior to Alliances and Markets? An Empirical Test of Cross-Border Knowledge Building. *Organization Science*, 13(2): 147-161.

Ambos, B. and Schlegelmilch, B.B. (2010). *The New Role of Regional Management*. Houndmills: Palgrave Macmillan.

Ardichvili, A., Maurer, M., Li, W., Wentling, T. and Stuedemann, R. (2006). Cultural influences on knowledge sharing through online communities of practice. *Journal of Knowledge Management*, 10(1): 94-107.

Baines, T.S., Lightfoot, H.W., Benedettini, O. and Kay, J.M. (2009). The servitization of manufacturing. A review of literature and reflection on future challenges. *Journal of Manufacturing Technology Management*, 20(5): 547-567.

Birkinshaw, J. and Hood, N. (1998). Multinational Subsidiary Evolution. *Academy of Management Review* 23(4): 773-795.

Daniels, J.D. (1986). Approaches to European Regional Management by Large U.S. Multinational Firms. *Management International Review*, 26(2): 27-42.

Davies, A., Brady, T. and Hobday, M. (2007). Organizing Solutions – Systems seller vs. systems integrator. *Industrial Marketing Management*, 36(2): 183-193.

Dhanaraj, C., Lyles, M.A., Steensma, H.K., Tihanyi, L. (2004). Managing Tacit and Explicit Knowledge Transfer in IJVs – The Role of Relational Embeddedness and the Impact on Performance. *Journal of International Business Studies*, 35(5): 428-442.

Enright, M.J. (2005). Regional Management Centres in the Asia-Pacific. *Management International Review*, 45(1) Special Issue, 59-82.

Freiling, J. (2012). New Service Ventures – Struggling for Survival, in Burger-Helmchen, T. (Ed.). *Entrepreneurship – Creativity and Innovative Business Models*. (99-114), InTech, Rijeka.

Foss, N. and Pedersen, T. (2002). Transferring knowledge in MNCs: The role of sources of subsidiary knowledge and organizational context. *Journal of International Management*, 8(1): 49-67.

Foss, N. and Pedersen, T. (2004). Organizing Knowledge Processes in the Multinational Corporation – An Introduction. *Journal of International Business Studies*, 35(5): 340-349.

Freiling, J. and Dressel, K. (2014). Exploring constrained rates of adoption of 'Total Cost of Ownership' models: A service dominant logic analysis, *International Small Business Journal* 32, published online March 12, 2014, doi:10.1177/0266242613519118

Gebauer, H., Edvardsson, B. and Bjurko, M. (2010). The impact of service orientation in corporate culture on business performance in manufacturing companies. *Journal of Service Management*, 21(2), 237–259.

Ghemawat, P. (2005). Regional Strategies for Global Leadership. *Harvard Business Review*, 83(12): 98-108.

Gupta, A. and Govindarajan, V. (2000). Knowledge Flows within Multinational Corporations. *Strategic Management Journal*, 21(4): 473-496.

Hansen, M. (2002). Knowledge Networks – Explaining Effective Knowledge Sharing in Multi-unit Companies. *Organization Science*, 13(3): 232-248.

Ho, K.C. (1998). Corporate regional functions in Asia Pacific. *Asia Pacific Viewpoint*, 39(2): 179-191.

Kähäri, P. (2014). Why do regional headquarters live and die? Helsinki: Aalto University School of Business.

Lasserre, P. (1996). Regional Headquarters: The Spearhead for Asia Pacific Markets. *Long Range Planning*, 29(1): 30-37.

Laudien, S.M. and Freiling, J. (2011). Overcoming Liabilities of Foreignness by Modes of Structural Coordination: Regional Headquarters and their Role in TNCs, *Advances in International Management* 24: 107-125.

Li, G.-H., Yu, C.-M. and Seetoo, D.H. (2010). Toward a Theory of Regional Organization, *Management International Review*, 50: 5-33.

Lunnan, R. and Zhao, Y. (2014). Regional headquarters in China: Role in MNE knowledge transfer. *Asia Pacific Journal of Management*, 31 (2): 397-422.

Piekkari, R., Nell, P. and Ghauri, P.N. (2010). Regional Management as a System – A Longitudinal Case Study. *Management International Review*, 50 (4), 513-532.

Piekkari, R. and Welch, C. (2011, Eds.). *Rethinking the Case Study in International Business and Management Research*, Cheltenham, UK: Edward Elgar.

Poon, J. P. H. and Thompson, E. R. (2003). Developmental and quiescent subsidiaries in the Asia Pacific: Evidence from Hong Kong, Singapore, Shanghai, and Sydney. *Economic Geography*, 79(2): 195-214.

Ramírez, R. (1999). Value Co-Production – Intellectual Origins and Implications for Practice and Research. *Strategic Management Journal*, 20(1): 49-65.

Roth, K. and Kostova, T. (2003). The use of the multinational corporation as a re-search context. *Journal of Management*, 29: 883-902.

Rugman, A.M. (2005). *The Regional Multinationals*, Cambridge: Cambridge University Press.

Rugman, A.M. and Verbeke, A. (2009). Location, Competitiveness, and the Multinational Enterprise, in Rugman, Alan (ed.) *The Oxford Handbook of International Business*. Oxford: Oxford University Press. 146-180.

Schütte, H. (1997). Strategy and Organisation: Challenges for European MNCs in Asia. *European Management Journal*, 15(4): 436-445.

Vandermerve and Rada (1988). Servitization of Business: Adding Value by Adding Services. *European Management Journal*, 6(4): 314-324.

Vargo, S.L. and Lusch, R.F. (2004). Evolving to a new dominant logic for marketing. *Journal of Marketing*, 68(1): 1-17.