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Corporate Governance and Globalization: Toward an Actor-Centred Institutional Analysis

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Introduction

Despite globalization, multinational companies (MNCs) continue to be heavily influenced by the *institutional context* of the country in which their corporate headquarters are located (Ferner and Quintanilla 1998). For example, European MNCs accounted for 32 per cent of the world's 500 largest firms in 2001 (*Fortune Global 500*, 2002). But there is a large discrepancy between each European country's share of the top 500 MNCs and its share of population or gross domestic product (GDP). So the UK accounts for 22 per cent of all Western European companies in the *Fortune Global 500* in 2002, but only 15 per cent of population (in Western Europe) and 17 per cent of GDP; while Italy accounts for similar proportions of population and GDP but only 5 per cent of European *Fortune Global 500* MNCs. In this chapter, we argue that the discrepancy in the degree of globalization is partially explained by the country's institutional environment. In particular, we draw on actor-centred institutionalism to identify how corporate governance actors might influence globalization.

Previous studies examining variations in globalization have not addressed the role of national corporate governance systems from the corporate stakeholders' point of view. In this chapter, we develop a

* We gratefully acknowledge the support of the UK Economic and Social Research Council.

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theoretical framework that shows how differences among European corporate governance systems can significantly explain variation in the globalization of MNCs.

Various explanations exist for MNCs' globalization discrepancies, such as the history of industrialization (Gerschenkron 1962; Chandler, Amatori and Hikino 1997) and the relative advantages of companies from different national bases (Porter 1990). 'Globalization' constitutes both geographic spread and global integration of strategy and organization (Yip 1992, 2003, p. 1). Our interest lies in explaining these two aspects of globalization, particularly the latter, rather than the more traditional focus on explaining a firm's percentage of international revenues.

An actor-centred institutional analysis

Our main assumption is that the institutional environment – and, in particular, corporate governance stakeholders – will shape firms' globalization patterns. Although there exist different schools of thought within institutional theory (see DiMaggio and Powell 1991; Whitley 1992, 1999; Hall and Soskice 2001; Scott 2001; Aguilera and Jackson 2003; Federowicz and Aguilera 2003), we view institutions as influencing the *range* but not determining *outcomes* within organizations. In addition, we do not deny the agency role of actors within organizations (Oliver 1991) and hence stress the interplay of institutions and firm-level actors (Sharpf 1997). Institutions shape the social and political processes of how actors' interests are defined ('socially constructed'), aggregated and represented with respect to the firm. However, institutions are themselves the result of strategic interactions in different domains generating shared beliefs that in turn impact those interactions in a self-sustaining manner (Aoki 2001; Aguilera and Jackson 2003). The task for our actor-centred institutional model is, therefore, to specify how the role of each governance actor is shaped by different national institutional domains and thereby generates different types of conflicts and coalitions within the firm, in turn influencing the firm globalization patterns through different elements of global strategy and global organization.

We consider the most important governance actors who might affect globalization: employees, shareholders, the board of directors, top management teams and governments. Obvious omissions are customers and competitors, but being external to the firm they have less interaction with corporate governance. In sum, we examine in detail the mechanisms by which the corporate governance context in which each actor is embedded influences the actor's decisions on key aspects of globalization.

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This theoretical exercise fills two important gaps in the international business literature. First, to our knowledge there is only one study looking at the corporate governance dimensions of the multinational firm and internationalization patterns. Fukao's (1995) analysis of the corporate governance of the multinational *vis-à-vis* its subsidiaries is the closest in the field of global strategy. Second, an edited volume by Morgan, Kristensen and Whitley (2001), on the organization of the MNC across institutional and national divides, demonstrates the 'relatively limited institutionalization of worldwide governance regimes' (p. 32). Their argument is the starting point for examining how differences in governance affects globalization.

Corporate governance as a source of variance in globalization

We conceptualize 'corporate governance' broadly as the *set of interests and practices undertaken by shareholders and stakeholders of the firm*. We focus on how five main governance actors (employees, shareholders, the board of directors, top management teams, and government) behave towards the firm. We have identified these five governance actors because they are representative of the different interests shaping firm strategy. These interests are not always aligned. Since our level of analysis is the country, we necessarily stylize our conceptualization of each governance actor within a given country, making them almost 'ideal-types'. Moreover, we limit our discussion to the Corporate governance systems of the headquarters or home country, as that is the regime that has the most influence. While, the Corporate governance rules of countries in which the MNC has important subsidiaries will also have some influence, this tends to be much less than that of the home country.

Existing frameworks for globalization usually have three constructs: industry globalization drivers, global strategy elements and global organization factors (for example, Yip 1992). Government drivers are frequently included under industry aspects, but focus on intercountry rules such as trade and foreign direct investment (FDI) regimes. But these government drivers of globalization ignore intracountry rules in terms of governance. These prior studies also neglect the moderating effects of institutions. Admittedly, studies of the globalization of *countries* placed heavy emphasis on institutions (for example Porter 1990; Rugman 2000). However, studies of the globalization of *companies* have not. Institutional theory would say that historical legacies and national institutional complementarities explain the behaviour of country MNCs. The essence of

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global strategy theory is the balance among industry drivers and strategy (Porter 1986; Yip 1989; Morrison 1990) and organization and strategy (Prahalad and Doz 1987; Bartlett and Ghoshal 1989; Martínez and Jarillo, 1989; Birkinshaw and Morrison 1995; Westney and Zaheer 2001). Similarly, institutions create a balance and constraint on possible strategies and organizational forms.

Corporate governance is likely to affect all aspects of global integration. Using Yip's (1992) categories, these aspects are the five elements of *global strategy* – global market participation, global products and services, global activity location, global marketing and global competitive moves; and the four elements of *global organization* – global organization structure, global management processes, global human resources and global culture. In this Chapter, we provide a systematic analysis of how Corporate governance might affect global strategy and global organization, which in turn will shape the patterns of globalization. The rest of this chapter discusses how particular aspects of Corporate governance, especially as related to actors in Corporate governance within an institutional context, affect globalization outcomes.

Roles of corporate governance actors in globalization

In this section, we conduct a stylized theoretical analysis to explain the logic that could predict how each corporate governance actor will behave towards global strategy and global organization that in turn will lead to a particular pattern of globalization mode. It is worth noting that this discussion refers to ideal-types for case of categorization.

Employees

The role of home country employees in corporate governance varies by country, as determined by the existing institutional arrangements. As discussed earlier, we focus on home–HQ countries, as any role of employees in corporate governance is overwhelmingly shaped at the corporate rather than the subsidiary level. Admittedly, there can be local roles, such as in the closing of facilities and local work rules, but these operate at a lower level of strategy.

Employees can have different mechanisms for influencing firm governance, depending on the corporate governance regime in which they operate. Examples of employee voice are board representation, work councils, equity ownership, unions, consultation rights and rules on working conditions and job security. The capacity of employees' to *influence the firm* will have important effects for the firm's ability to

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undertake global strategy and organization. We operationalize employees' involvement in terms of their ability to influence the firm's decision making.

Regarding the strategy dimensions of global integration, a strong corporate governance role for employees should be favourable to *global market participation*, as this latter applies to the global expansion of sales and therefore should favour home employment rather than threaten it. Similarly, the strong involvement of labour in firm governance shapes the characteristics of global products and services. A successful *global product strategy* requires not just the right design but also the ability to manufacture to world-class standards. Companies based in countries that for whatever reason cannot produce to world-class standards will, therefore, find it hard to adopt a global product strategy. On the other hand, too much employee involvement can have deleterious effects on product or service quality.

Conversely, employees having a strong voice within the firm's corporate governance should: (1) make it harder for an MNC to relocate activities globally outside the home country, (2) have a small negative effect on the use of global marketing, at the margin, strong home country employees may prefer marketing that retains national identity; and (3) make it harder for an MNC to make global competitive moves, as these often require sacrifice of home country position, resources, revenues or profits, and hence domestic jobs or working conditions.

Regarding the effects on global organization, we would expect that employees having a strong corporate governance role will not favour any global strategy lever because they would contribute to either fewer home country jobs or to decrease the quality of home country jobs. For instance, the implementation of global human resource (HR) policies is likely to transplant jobs across different subsidiaries and to introduce efficiency policies that are likely to impoverish home country employment practices such as work organization or performance incentives.

Shareholders

Shareholders of large public MNCs (which are our focus) play differing roles in different countries. At one extreme, the USA and the UK have mostly arm's length, neutral shareholders, who are focused on maximization of shareholder value. Although many American and British shareholders are large institutions, these have to date played mainly passive roles. Japan also has many institutional shareholders, but these tend not to be neutral and often act as part of a network ('*keiretsu*') that supports the role of the company within the network and, hence,

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incumbent management. Germany has many companies where different stakeholders, particularly banks and institutional shareholders, play a leading role in influencing corporate policy.

We distinguish between *neutral shareholders* and those with *vested interests* (*partial*). By 'neutral' we mean that the overriding concern of the shareholders is to maximize profits and shareholder value. Interested shareholders also care about other objectives, sometimes ahead of shareholder value. Employee shareholders nearly always have the partial interest of some bias against maximizing shareholder value in favour of employment levels, pay or conditions. We consider shareholders such as banks or institutional investors as partial interest shareholders, as they will have several interests at stake in addition to shareholder value maximization. In Japan, institutional shareholders hold maintenance of the overall *keiretsu* as a major objective. In Germany, institutional shareholders typically have close ties and loyalty to management. In all countries, state shareholders pursue additional objectives such as maintaining employment, national security, competitiveness and prestige. Family shareholders also tend to be concerned with the family's legacy, loyalty to employees and tradition, and can also be risk averse. This latter point generally applies to second or later generations than to that of the founders.

In summary, neutrality or partiality is a function of several shareholder attributes: the typical roles in a country of institutional shareholders and of governmental shareholders, the prevalence of first versus second or later generation family shareholders, the extent of shareholdings by managers and lastly the degree of concentration that will allow the exercise of shareholder influence. Hence we prefer to use neutrality versus partiality of shareholder interests as the key defining characteristic of shareholder behaviour that affects globalization, although partial shareholders will need some degree of concentrated ownership in order to exercise influence.

We expect that shareholders will manifest different positions regarding the five global strategy levers. First, most shareholders, whether neutral or partial, should be in favour of *global market participation*, as that usually helps rather than hurts domestic interests such as higher firm revenues. Second, we argue that whether shareholders are neutral or partial probably has little effect on the ability of MNCs to produce *globally competitive products and services*. For example, Japan and Germany produce on average the highest quality global products (as confirmed in various surveys) and have similar types of shareholder interests (large institutions that favour incumbent management and the status quo).

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France and Italy have relatively large shareholdings by partial government shareholders but are not as successful in producing global products except in some niche areas (especially in the case of Italy). The USA and UK have similar corporate governance in terms of having mostly neutral shareholders. But the USA has many more companies with successful global products while Britain has almost no global products left, but a significant number of globally competitive services (especially in finance, airlines and creative industries).

Third, neutral shareholders should favour *global relocation of activities* if that is in the best interests of the company and ultimately shareholder value. Some types of partial shareholders may oppose global relocation; in particular, significant equity ownership by home country employees makes it difficult for companies to move jobs overseas. Many government shareholders also seek to protect domestic employment. Some family shareholders may also have sentimental or altruistic reasons for preserving domestic employment. Fourth, partial shareholders should have a small negative effect on the use of *global marketing*. At the margin, some home country shareholders, such as employees and governments, may prefer marketing that retains national identity. Second and later generation family shareholders may also seek to preserve a company heritage that has a national identity. Finally, partial shareholders with home country interests, such as employees and governments, should make it harder for an MNC to make *global competitive moves*, as these often require sacrifice of home country position, resources, revenues or profits, and hence domestic jobs or working conditions.

The existing literature provides little guidance on the relationship between shareholder interests and global organization. First, even partial shareholders with domestic interests should favour *global organization structures* so long as the home country is dominant. An exception is that state owners may favour country-based organization structures, or a domestic–international split in order to preserve home country jobs, investment, or influence. A change from national family ownership to foreign or neutral ownership can trigger reorganization toward a global structure. Second, partial shareholders should favour *global management processes* so long as the home country processes dominate. Third, some types of partial shareholders, especially employees, should make it harder for an MNC to have *global HR policies*, as they will favour the employment and advancement of home country nationals. Family shareholders may also find it hard to apply neutral global HR policies. Finally, firms controlled by family shareholders and domestic employee shareholders may find it hard to create a *global culture*.

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Board of directors

Boards of directors vary importantly in terms of their structure, composition and activeness (Daily and Dalton 1994). German boards have a dual structure, with a supervisory board ('*Aufsichsrat*') above a management board ('*Vorstand*'). The supervisory board has various statutory duties, particularly the appointment of the members of the management board and supervision of their actions. German companies with very restricted shareholdings can take the form of a GmbH and operate with only one board. In the UK, most boards adhere to the Cadbury Report's recommendation of having a non-executive chairman; in the other countries, the roles of chief executive (CEO) and chairman are often combined, especially in the USA. Another aspect of board structure is the role of committees, which varies depending on the strategic leadership of the board. In general, we do not believe that board structure *per se* makes a difference to globalization.

The composition of boards in major OECD countries varies by both custom and law. British boards have a high proportion, usually a majority, of corporate executives, with very few external directors. On the other hand, British chairmen are typically outsiders. In contrast, US boards mostly have a majority of outside directors, but the chairman is usually an insider, either a past or current CEO. French boards are becoming Anglicized owing to foreign institutional investor pressures. German supervisory boards are required by the Co-Determination Laws to have employee representatives, their number and proportion depending on the size of the company. In the other countries, labour representation and participation in firm decision making is rare, except where they are significant shareholders. State owned firms also tend to have higher labour representation. Japanese boards usually include representatives of other *keiretsu* members.

Countries also vary in the extent to which major shareholders have board representation. In the USA and UK, large institutional shareholders have only very recently sought representation on boards. In contrast, in Germany, and France, it is the norm to have major shareholders, such as banks or institutional investors, sitting on the board. Boards with a majority of directors who represent shareholders are more likely to globalize. They are less risk averse than boards dominated by non-shareholders, because they will be less constrained by non-shareholder interests such as the preservation of HQ country jobs and investment. Hence, such firms are more likely to favour globalization strategies, particularly global market participation and global activity location, even

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if they adversely affect stakeholders such as HQ country employees and suppliers. Similarly, such firms are more likely to use global management processes because they will seek value-maximizing behaviour more than preservation of traditional, country centred methods.

The insider–outsider split probably has mixed effects on globalization. On the one hand, outsiders (unless they represent special interests) should be able to make the most neutral tradeoffs about the risks involved in globalization. Boards dominated by neutral outsiders should be less risk averse than boards dominated by insiders, because they do not have their shares or job security at stake. Outsider directors are more likely to favour globalization strategies, particularly global market participation and global activity location, as they have few, if any, ties to HQ country employees. On the other hand, insiders typically have motives of empire building and incentive pay to offset any inherent preference for the status quo. Hence, performance evaluation and reward are also critical.

Globalization should be affected by boards having *partial* members: representatives of employees, network partners, suppliers, customers, governments or non-governmental organizations (NGOs). Partial boards will bias decisions away from pure profit and shareholder value maximization, and hence the optimal globalization strategy, in favour of their particular constituencies. We predict that employee, government and NGO board representatives pose might prevent fully-fledged globalization in order to promote their own interests. In contrast, representation of major shareholders, provided they have neutral interests, as discussed earlier, should favour globalization. Generally speaking, we will argue that, other things being equal, neutral boards will be more likely to favour the right globalization strategies.

We propose that globalization strategies will be most facilitated by having boards that have *neutral* interests favouring shareholder value. British and American boards rate highest on these measures, German boards lowest and French, Italian and Japanese boards in between. Having already discussed how employee and shareholder roles affect each of the nine elements of globalization, we need not repeat this analysis for boards. We propose that neutral boards will favour all nine elements of global strategy and organization.

Top management teams

Top management teams (TMTs) vary across countries in terms of their mobility and their background. In general, we expect that TMTs comprising mobile, professional managers are more likely to globalize. The

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more important distinction is whether the TMT acts in a *fiduciary* as opposed to an *autonomous* basis. Top managers with lifetime employment in the firm are more likely to act as fiduciaries for stakeholder interests and be more conservative about globalization. Similarly, those top managers who view themselves as professional managers rather than as specialists in a function are also more likely to make the balanced assessments needed for globalization. We expect that companies with mobile, professional TMTs will favor all nine elements of global strategy and organization, and adopt the most aggressive globalization strategies.

Governments

Governments can intervene in a business in two main ways. First, they set the general rules and regulatory regimes that apply to all companies in a country or all companies within a given category (for example, telecommunications companies). These rules and regimes also typically distinguish between domestic and foreign firms, and between domestic activities and foreign activities. For example, there may be general rules about the export of jobs and the import of foreign labour, or about the closing of operations. Second, governments may intervene in individual cases, such as whether to allow a particular company to be sold to a foreign buyer. Governments have many interests to motivate their behaviour. In the case of globalization, the two most important interests are probably the enhancement of national competitiveness and the preservation of employment. Both interests are likely to conflict with MNCs' free pursuit of globalization, especially in the short term. In general, MNCs seek to ignore HQ country considerations if at all possible in their globalization decisions, while national governments will inherently seek to intervene in favour of their country; and governments in the HQ country have the greatest influence in corporate governance. Countries differ in the degree to which their governments intervene in the affairs of MNCs, for ideological, political and legal reasons.

We first explore the relationship between interventionist governments and global strategy. Interventionist governments are more likely to encourage *global market participation* so long as jobs are not exported. They will also prefer exports as the mode of market participation rather than the setting up of overseas subsidiaries. They should in theory favour the development of globally successful *products and services*. In practice, protection often, but not always, produces less competitive products. In addition, they will make it harder for MNCs to *locate* activities globally outside the home country, usually to preserve employment.

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Even liberal governments, such as that of the USA, can discourage some global relocations. Although they will probably be neutral as to whether domestic MNCs use global as opposed to national *marketing*, such governments may have a slight preference for preserving aspects of national identity. Interventionist governments should make it harder for an MNC to make *global competitive moves*, as these often require sacrifice of home country position, resources, revenues or profits, and hence domestic jobs or working conditions.

As for the relationship between interventionist government and global organization, protectionist governments should: (1) favour global *organization structures* so long as the home country is dominant; (2) favour *global management processes* so long as the home country processes dominate; (3) make it harder for an MNC to have *global HR policies*, as they will favour the employment and advancement of home country nationals; as well as (4) make it harder for an MNC to implement a global, rather than home country, *culture*.

Conclusion

The above analysis argues that strong roles for each corporate governance actor predict particular globalization models. Our proposed theoretical model fills a gap in the global strategy and organizational literature in that it accounts for the institutional factors that might shape organizational globalization. Drawing from actor-centred institutionalism, we select five key governance actors that will influence a firm's globalization strategy. Our model suggests that in order to understand corporate behaviour such as globalization strategies, it is necessary to comprehend the dynamics of the different actors related to the firm.

A critical contribution of our theoretical model stems from the systematic comparative perspective that permits comparisons across countries. Future research should operationalize the proposed conceptual variables and empirically test our propositions.

When firms need to grow, managers have different diversification choices. If they choose to tap into other markets through geographical diversification, then they should be aware of the actor-centred institutional factors that will determine their globalization decisions. Understanding the institutional environment within which firms operate at the national level will allow managers to align the different actors' interests and capabilities with their own firms' globalization modes.

To a large extent the MNC behaviour we have described as favouring globalization – risk taking, willingness to change, long-term maximization

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of profits and shareholder value and neutrality toward domestic national interests – is also the same as that favouring the long-term health and competitiveness of a nation's companies. Hence the national corporate governance systems that favour globalization also favour long-term corporate competitiveness.

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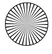
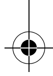
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