Global Business Today 6e

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McGraw-Hill/Irwin

Chapter 11

The Strategy of International Business

Introduction

- Question: What actions can managers take to compete more effectively in a global economy?

- Managers must consider
  - the benefits of expanding into foreign markets
  - which strategies to pursue in foreign markets
  - the value of collaboration with global competitors
  - the advantages of strategic alliances

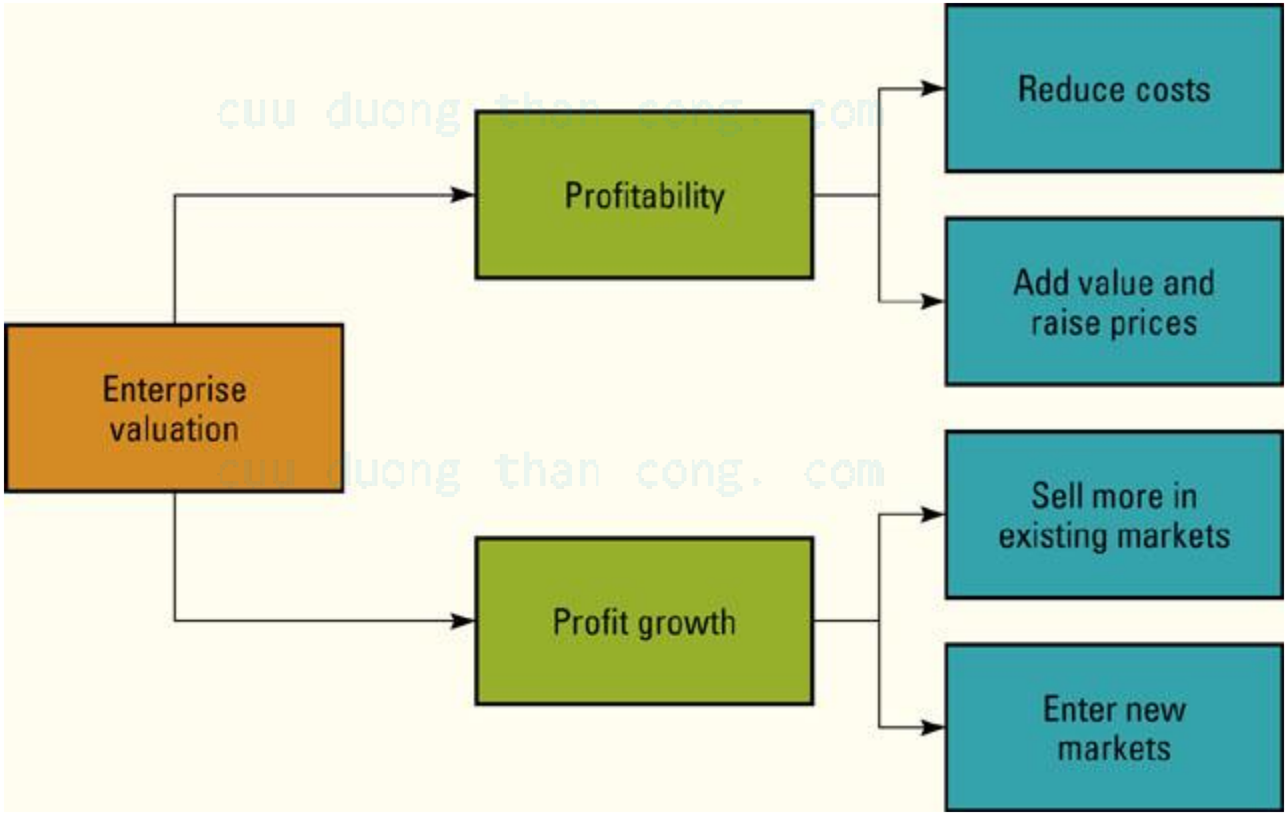
Strategy and the Firm

Question: What is strategy?

- A firm's strategy can be defined as the actions that managers take to attain the goals of the firm
- Typically, strategies focus on profitability and profit growth
- Profitability refers to the rate of return the firm makes on its invested capital
- Profit growth is the percentage increase in net profits over time

Strategy and the Firm

Determinants of Enterprise Value



Value Creation

Question: How do you increase the profitability of a firm?

- To increase profitability, value must be created for the consumer
- Value creation is measured by the difference between V (the price that the firm can charge for that product given competitive pressures) and C (the costs of producing that product)
- The two basic strategies for creating value are
  1. differentiation
  2. low cost

Strategic Positioning

- To maximize profitability, a firm must
  - pick a position on the efficiency frontier that is viable in the sense that there is enough demand to support that choice
  - configure its internal operations so that they support that position
  - make sure that the firm has the right organization structure in place to execute its strategy
- So, a firm’s strategy, operations, and organization must all be consistent with each other in order to achieve a competitive advantage and superior profitability

Operations: The Firm as a Value Chain

- Firms are essentially value chains composed of a series of distinct value creation activities, including production, marketing, materials management, R&D, human resources, information systems, and the firm infrastructure
- Value creation activities can be categorized as
  1. primary activities
  2. support activities

Operations: The Firm as a Value Chain

1. Primary Activities

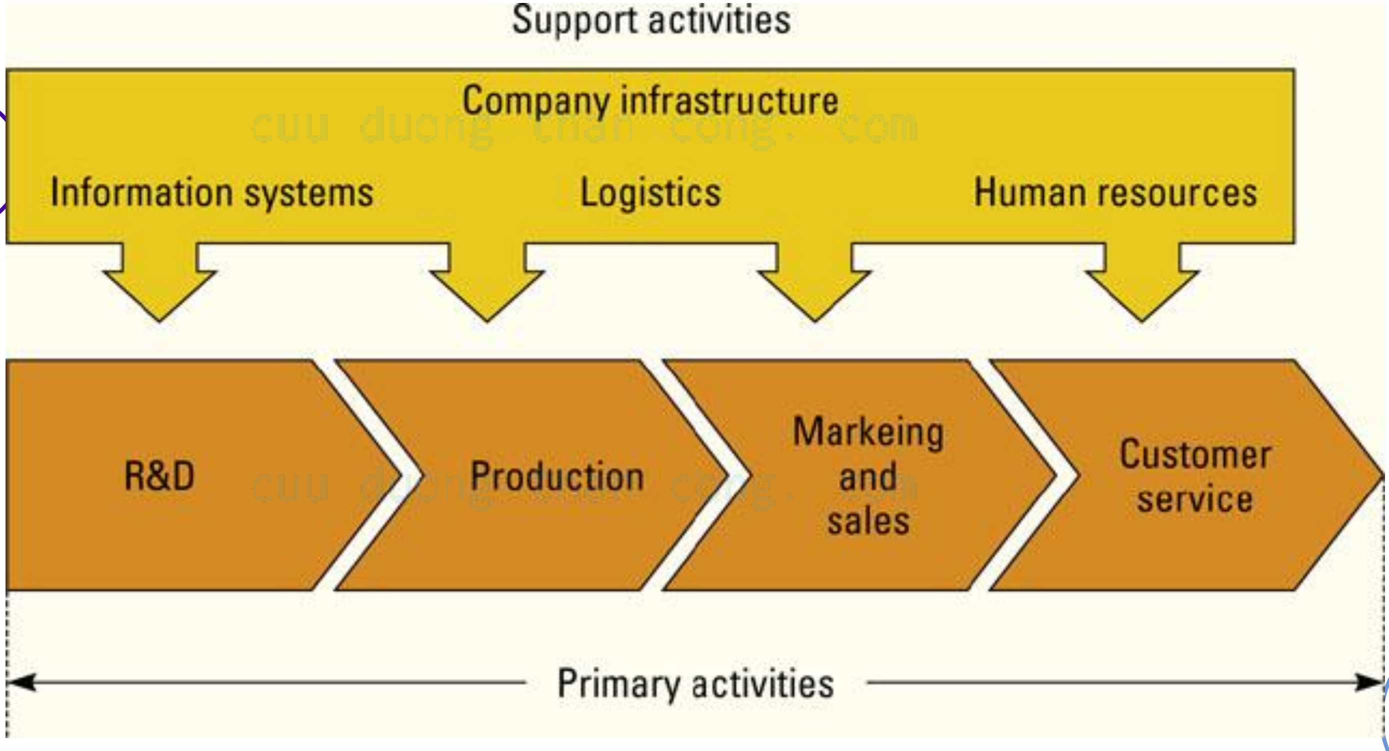
- involves creating the product, marketing and delivering the product to buyers, and providing support and after-sale service to the buyers of the product

2. Support Activities

- provides the inputs that allow the primary activities of production and marketing to occur

Operations: The Firm as a Value Chain

The Value Chain



Classroom Performance System

All of the following are examples of primary activities except

a) Logistics

b) Marketing and sales

c) Customer service

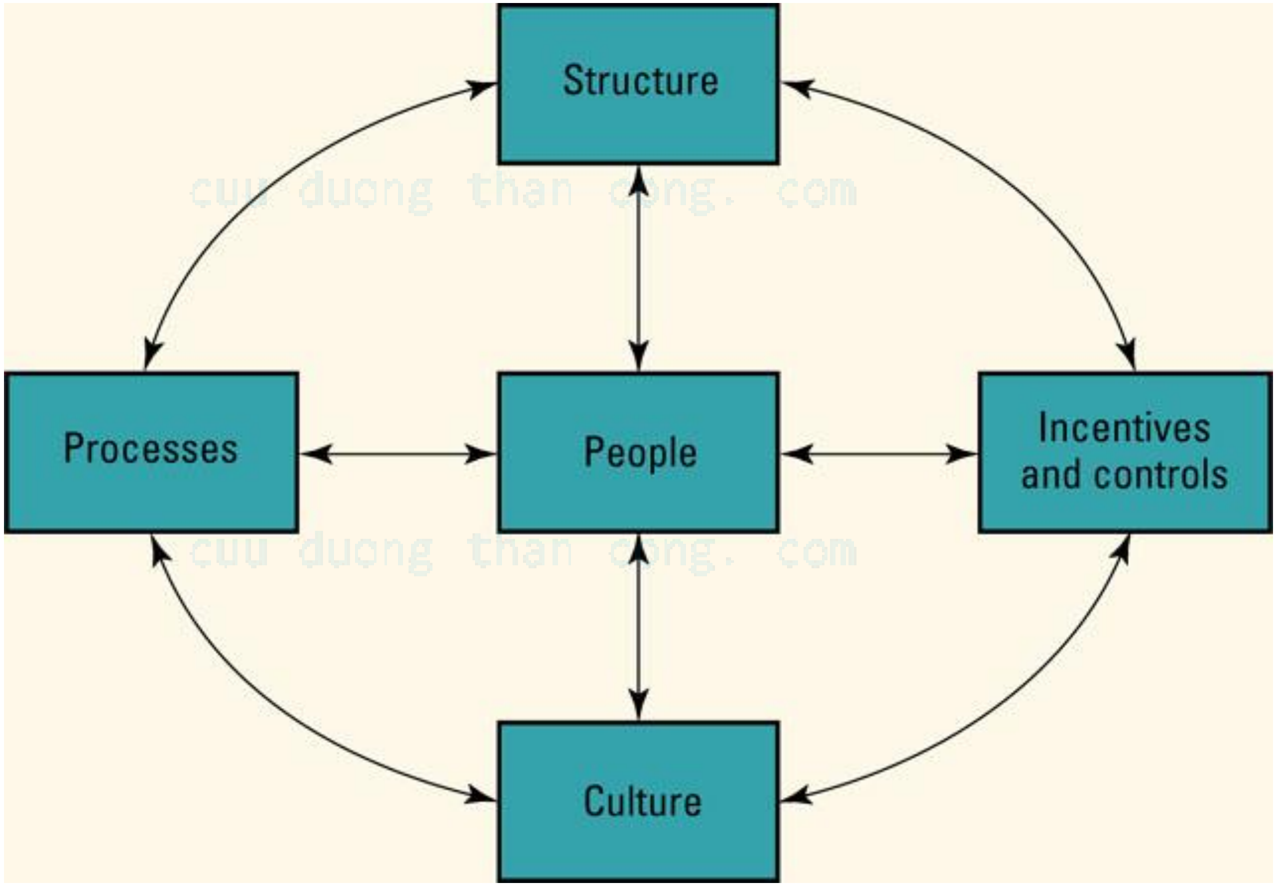
d) Production

Organization: The Implementation of Strategy

- Organization architecture refers to the totality of a firm's organization (formal organizational structure, control systems and incentives, organizational culture, processes, and people)
- Organizational structure refers to
  - the formal division of the organization into subunits
  - the location of decision-making responsibilities within that structure
  - the establishment of integrating mechanisms to coordinate the activities of subunits including cross functional teams and or pan-regional committees

Organization: The Implementation of Strategy

- Organization Architecture



Organization: The Implementation of Strategy

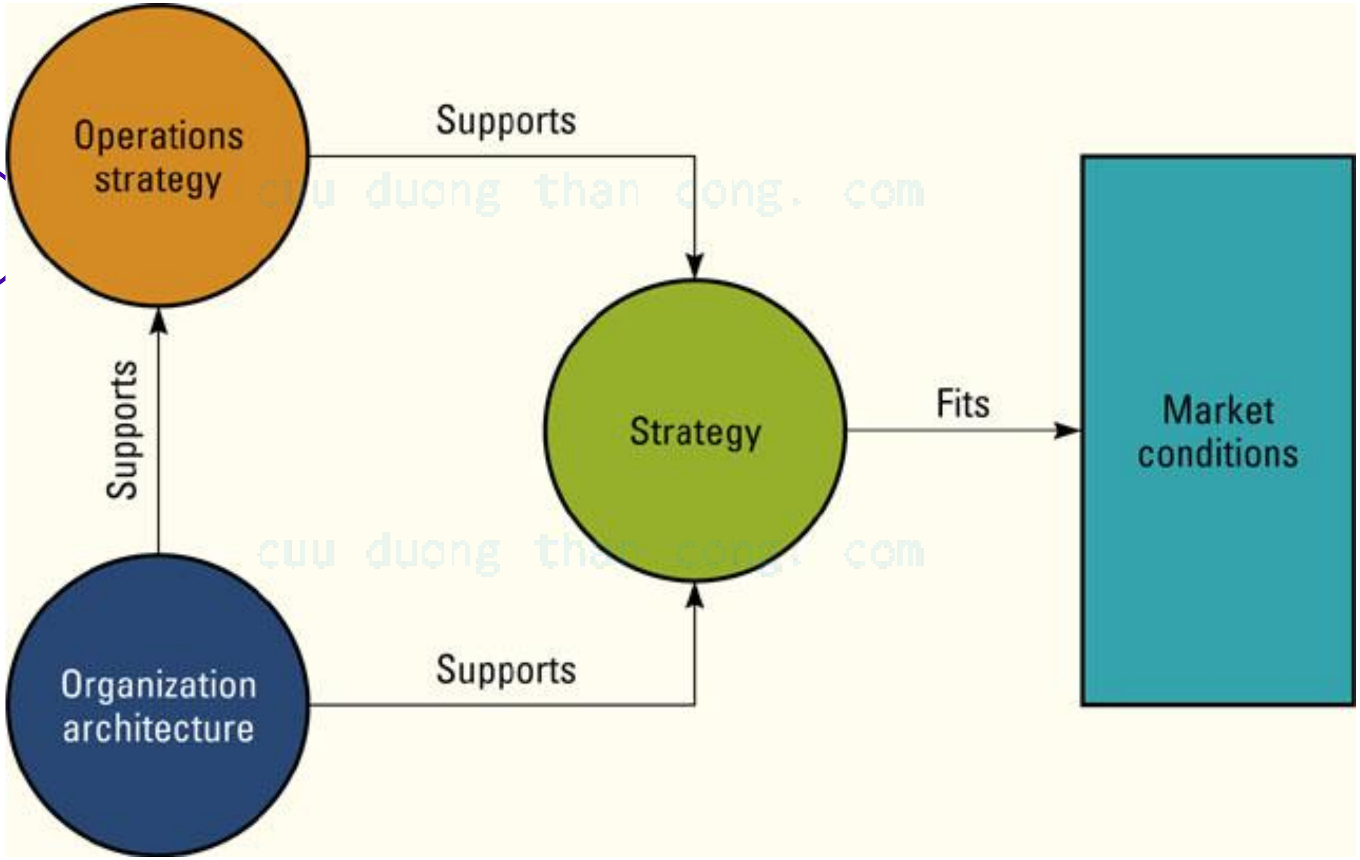
- Controls are the metrics used to measure the performance of subunits and make judgments about how well the subunits are run
- Incentives are the devices used to reward appropriate managerial behavior
- Processes are the manner in which decisions are made and work is performed
- Organizational culture is the norms and value systems that are shared among the employees
- People refers to employees and the strategy used to recruit, compensate, and retain those individuals

In Sum: Strategic Fit

- So, to attain superior performance and earn a high return on capital, a firm's strategy must make sense given market conditions
- The operations of the firm must support the firm's strategy
- The organizational architecture of the firm must match the firm's operations and strategy
- If market conditions shift, so must the firm's strategy, operations, and organization

In Sum: Strategic Fit

Strategic Fit



Global Expansion, Profitability and Profit Growth

- Firms that operate internationally can

1. Expand the market for their domestic product offerings by selling those products in international markets
2. Realize location economies by dispersing individual value creation activities to locations around the globe where they can be performed most efficiently and effectively
3. Realize greater cost economies from experience effects by serving an expanded global market from a central location, thereby reducing the costs of value creation
4. Earn a greater return by leveraging any valuable skills developed in foreign operations and transferring them to other entities within the firm's global network of operations

Expanding the Market: Leveraging Products and Competencies

- To increase growth, a firm can sell products or services developed at home in foreign markets
- Success depends on the type of goods and services, and the firm's core competencies (skills within the firm that competitors cannot easily match or imitate)
- Core competencies
  - enable the firm to reduce the costs of value creation
  - create perceived value so that premium pricing is possible

Location Economies

- Firms should locate value creation activities where economic, political, and cultural conditions are most conducive to the performance of that activity
- Firms that successfully do this can realize location economies (the economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be)
- Locating value creation activities in optimal locations
  - can lower the costs of value creation
  - can enable a firm to differentiate its product offering from those of competitors

Location Economies

- Multinationals that take advantage of location economies create a global web of value creation activities
- Under this strategy, different stages of the value chain are dispersed to those locations around the globe where perceived value is maximized or where the costs of value creation are minimized
  - However, introducing transportation costs and trade barriers complicates this picture
  - Political risks must be assessed when making location decisions

Experience Effects

- The experience curve refers to the systematic reductions in production costs that have been observed to occur over the life of a product
  - Studies show that a product's production costs decline by some quantity about each time cumulative output doubles
- Learning effects are cost savings that come from learning by doing
  - Labor productivity increases when individuals learn the most efficient ways to perform particular tasks and management learns how to manage the new operation more efficiently

Experience Effects

- Economies of scale refer to the reductions in unit cost achieved by producing a large volume of a product
- Sources include
  - the ability to spread fixed costs over a large volume
  - the ability of large firms to employ increasingly specialized equipment or personnel
- Serving a global market from a single location is consistent with moving down the experience curve and establishing a low-cost position

Leveraging Subsidiary Skills

- To help increase firm value, managers should
  - recognize that valuable skills can be developed anywhere within the firm's global network (not just at the corporate center)
  - incentive systems can encourage local employees to acquire new skills
  - develop a process to identify when new skills have been created
  - act as facilitators to transfer valuable skills within the firm

Summary

- Firms that expand internationally can increase their profitability and profit growth by
  - Entering markets where competitors lack similar competencies
  - Realizing location economies
  - Exploiting experience curve effects
  - Transferring valuable skills within the organization

Classroom Performance System

When different stages of a value chain are dispersed to those locations around the world where value added is maximized or where the costs of value creation are minimized, ______ is (are) created.

a) Experience effects

b) Learning effects

c) Economies of scale

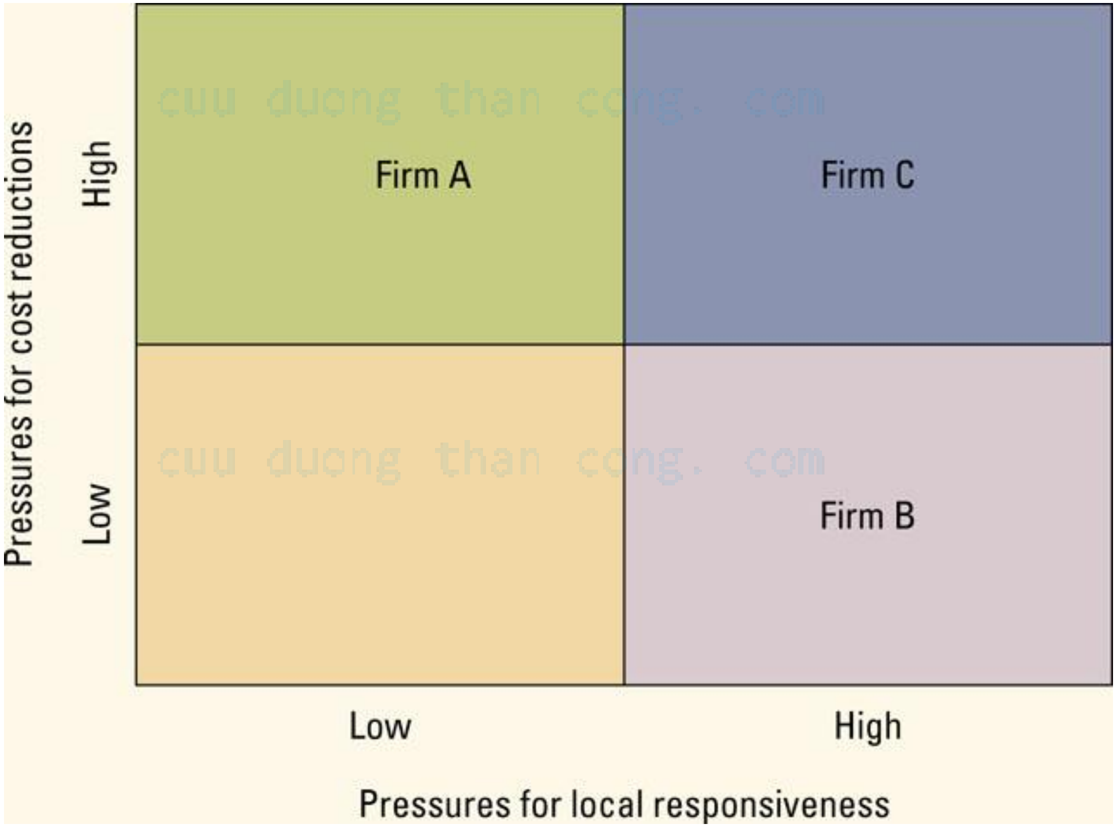
d) A global web

Cost Pressures and Pressures for Local Responsiveness

- Firms that compete in the global marketplace typically face two types of competitive pressures
  1. pressures for cost reductions
  2. pressures to be locally responsive
- These pressures place conflicting demands on the firm

Cost Pressures and Pressures for Local Responsiveness

Pressures for Cost Reductions and Local Responsiveness



Pressures for Cost Reductions

- Pressures for cost reductions are greatest
  - in industries producing commodity type products that fill universal needs (needs that exist when the tastes and preferences of consumers in different nations are similar if not identical)
  - when major competitors are based in low cost locations
  - where there is persistent excess capacity
  - where consumers are powerful and face low switching costs
- To respond to these pressures, firms need to lower the costs of value creation

Pressures for Local Responsiveness

- Pressures for local responsiveness arise from
  1. differences in consumer tastes and preferences
  2. differences in traditional practices and infrastructure
  3. differences in distribution channels
  4. host government demands
- Firms facing these pressures need to differentiate their products and marketing strategy in each country

Pressures for Local Responsiveness

1. Differences in Consumer Tastes and Preferences
   - When consumer tastes and preferences differ significantly between countries, firms face strong pressures for local responsiveness
2. Differences in Infrastructure and Traditional Practices
   - When there are differences in infrastructure and/or traditional practices between countries, pressures for local responsiveness emerge

Pressures for Local Responsiveness

3. Differences in Distribution Channels

- A firm's marketing strategies may be influenced by differences in distribution channels between countries

4. Host Government Demands

- Economic and political demands imposed by host country governments may necessitate a degree of local responsiveness

Classroom Performance System

Pressures for local responsiveness come from all of the following except

a) Excess capacity

b) Host government demands

c) Differences in consumer tastes and preferences

d) Differences in distribution channels

Choosing a Strategy

Question: How do the pressures for cost reductions and local responsiveness influence a firm's choice of strategy?

- There are four basic strategies to compete in the international environment
  1. global standardization
  2. localization
  3. transnational
  4. international

Global Standardization Strategy

Question: When does a global standardization strategy make sense?

- A global standardization strategy focuses on increasing profitability and profit growth by reaping the cost reductions that come from economies of scale, learning effects, and location economies
  - The strategic goal is to pursue a low-cost strategy on a global scale
- This strategy makes sense when there are strong pressures for cost reductions and demands for local responsiveness are minimal

Localization Strategy

Question: When does a localization strategy make sense?

- A localization strategy focuses on increasing profitability by customizing the firm's goods or services so that they provide a good match to tastes and preferences in different national markets
- This strategy makes sense when there are substantial differences across nations with regard to consumer tastes and preferences, and where cost pressures are not too intense

Transnational Strategy

Question: When does a transnational strategy make sense?

- A transnational strategy tries to simultaneously
  - achieve low costs through location economies, economies of scale, and learning effects
  - differentiate the product offering across geographic markets to account for local differences
  - foster a multidirectional flow of skills between different subsidiaries
- This strategy makes sense when there are both high cost pressures and high pressures for local responsiveness

International Strategy

Question: When does an international strategy make sense?

- An international strategy involves taking products first produced for the domestic market and then selling them internationally with only minimal local customization
- This strategy makes sense when there are low cost pressures and low pressures for local responsiveness

The Evolution of Strategy

Question: Is the choice of strategy static?

- As competition increases, international and localization strategies become less viable
- To survive, firms may need to shift to a global standardization strategy or a transnational strategy in advance of competitors

Classroom Performance System

When pressures are high for local responsiveness, but low for cost reductions, a ________ makes sense.

a) Global standardization strategy

b) International strategy

c) Transnational strategy

d) Localization strategy

Strategic Alliances

Question: What is a strategic alliance?

- Strategic alliances refer to cooperative agreements between potential or actual competitors
- Examples include
  - formal joint ventures
  - short term contractual arrangements
- The number of international strategic alliances has risen significantly in recent decades

The Advantages of Strategic Alliances

Question: Why form a strategic alliance?

- Strategic alliances are attractive because they
  - facilitate entry into a foreign market
  - allow firms to share the fixed costs (and associated risks) of developing new products or processes
  - bring together complementary skills and assets that neither partner could easily develop on its own
  - can help establish technological standards for the industry that will benefit the firm

The Disadvantages of Strategic Alliances

Question: What are the drawbacks of strategic alliances?

- Strategic alliances can give competitors low-cost routes to new technology and markets
- Unless a firm is careful, it can give away more in a strategic alliance than it receives

Making Alliances Work

Question: How can firms increase the success of their alliances?

- Many international strategic alliances run into problems
- The success of an alliance seems to be a function of three main factors
  1. partner selection
  2. alliance structure
  3. the manner in which the alliance is managed

Making Alliances Work

1. Partner Selection

- A good partner
  - helps the firm achieve its strategic goals and has the capabilities the firm lacks and that it values
  - shares the firm's vision for the purpose of the alliance
  - does not expropriate the firm's technological know-how while giving away little in return

Making Alliances Work

2. Alliance Structure

- A good alliance should
  - be designed to make it difficult to transfer technology not meant to be transferred
  - have contractual safeguards to guard against the risk of opportunism by a partner
  - involve an agreement in advance to swap skills and technologies to ensure a chance for equitable gain
  - extract a significant credible commitment from the partner in advance

Making Alliances Work

3. Managing the Alliance

- A good alliance
  - requires managers from both companies to build interpersonal relationships
  - should promote learning from alliance partners
  - should promote the diffusion of learned knowledge throughout the organization

Critical Discussion Question

1. In a world of zero transportation costs, no trade barriers, and non-trivial differences between nations with regard to factor endowments, firms must expand internationally if they are to survive. Discuss.

Critical Discussion Question

2. Plot the position of the following firms on Figure 11.8 - Procter & Gamble, IBM, Nokia, Coca-Cola, Dow Chemical, US Steel, and McDonald's. In each case justify your answer.

Critical Discussion Question

3. Re-Read the Management Focus box on Procter & Gamble and then answer the following questions:

a) What strategy was Procter & Gamble pursuing when it first entered foreign markets in the period up until the 1980s?

b) Why do you think this strategy became less viable in the 1990s?

c) What strategy does Procter & Gamble appear to be moving toward? What are the benefits of this strategy? What are the potential risks associated with it?

Critical Discussion Question

4. What do you see as the main organizational problems that are likely to be associated with the implementation of a transnational strategy?

Critical Discussion Question

5. Reread the Management Focus box on the alliance between Cisco and Fujitsu. What are the benefits to Cisco and Fujitsu respectively of the alliance? What are the risks to Cisco? How can Cisco mitigate those risks?