Chapter Twelve

The Strategy of International Business
Opening Case

• Wal-Mart moved into other countries for three reasons
  - Growth opportunities at home were becoming constrained
  - It thought it could create value by transferring its business model to foreign markets
  - It wished to preempt other retailers that were also starting to expand globally
• Wal-Mart initially treated foreign markets much like the US; it did discover that this was not the correct approach
Opening Case

- To succeed abroad, Wal-Mart has had to customize its offering to local conditions while keeping its core strategies and operations the same in every market.
- Going global has yielded additional benefits as well:
  - Enhanced bargaining power with suppliers
  - The ability to transfer valuable ideas from one country to another
Strategy and the Firm

- Strategy can be defined as the actions that managers must take to attain the goals of the firm
  - For most firms, the preeminent goal is to maximize the value of the firm for its owners
- Profitability can be defined as the rate of return that the firm makes on its invested capital (ROIC), which is calculated by dividing the net profits of the firm by total invested capital
- Profit growth is measured by the percentage increase in net profits over time
Strategy and the Firm

Enterprise Valuation

Profitability
- Reduce Costs
- Add Value and Raise Prices

Profit Growth
- Sell More in Existing Markets
- Enter New Markets
Value Creation

- The way to increase the profitability of a firm is to create more value
  - The amount of value a firm creates is measured by the difference between its costs of production and the value that consumers perceive in its products
- Michael Porter states that there are two basic strategies for creating value and attaining a competitive advantage in an industry
  - Low-cost strategy suggests that a firm has high profits when it creates more value for its customers and does so at a lower cost
  - Differentiation strategy focuses primarily on increasing the attractiveness of a product
Value Creation

\[ V = \text{Value of product to an average consumer} \]
\[ P = \text{Price per unit} \]
\[ C = \text{Cost of production per unit} \]
\[ V-P = \text{Consumer surplus per unit} \]
\[ P-C = \text{Profit per unit sold} \]
\[ V-C = \text{Value created per unit} \]
Strategic Positioning

- It is important for a firm to be explicit about its choice of strategic emphasis with regard to value creation
  - Management must decide where the company wants to be positioned with regard to value and cost
- A central tenet of the basic strategy paradigm is: To maximize its profitability, a firm must do three things
  - Pick a position on the efficiency frontier that is viable in the sense that there is enough demand to support that choice
  - Configure internal operations so that they support that position
  - Make sure that the firm has the right organization structure in place to execute its strategy
Strategic Choice in the International Hotel Industry

- Increased Value/Differentiation (V)
- Efficiency Frontier
- Four Seasons
- Starwood
- Marriott
- Strategic Choices in This Area Not Viable in International Hotel Industry
- Low Cost (C)
The Value Chain

- Any firm is composed of a series of distinct value creating activities
  - Primary activities
    - Research & development
    - Production
    - Marketing & sales
    - Service
  - Support Activities
    - Materials management or logistics
    - Human resource
    - Information systems
    - Company infrastructure
Global Expansion, Profitability, and Profit Growth

- Expanding globally allows firms to increase their profitability and rate of profit growth in ways not available to purely domestic enterprises.
- Firms that operate internationally are able to:
  - Expand the market for their domestic products
  - Realize location economies by dispersing individual value creation activities
  - Realize greater cost economies
  - Earn a greater return by leveraging any valuable skills developed in foreign operations
The Value Chain

Support Activities

Company Infrastructure
- Information Systems
- Logistics
- Human Resource

Primary Activities
- R&D
- Production
- Marketing and Sales
- Customer Service
EXPANDING THE MARKET: LEVERAGING PRODUCT AND COMPETENCIES

• A company can increase its growth rate by taking goods or services developed at home and selling them internationally
  - Returns from such a strategy are likely to be greater if indigenous competitors in the nations a company enters lack comparable products

• Success of multinational companies also rest upon the core competencies that underlie the development, production, and marketing of goods or services
  - Core competencies are skills within the firm that competitors cannot easily match or imitate
  - Core competencies are the bedrock of a firm’s competitive advantage and enable them to reduce the costs of value creation
Location Economies

- Location economies are the economies that arise from performing a value creation activity in the optimal location for that activity.
- Can have one of two effects:
  - It can lower the costs of value creation and help the firm to achieve a low-cost position and/or
  - It can enable a firm to differentiate its product offering from those of competitors.
- One result of this kind of thinking is the creation of a global web of value creation activities, with different stages of the value chain being dispersed to those locations around the globe where perceived value is maximized or where the costs of value creation are minimized.
Experience Effects

• The experience curve refers to systematic reductions in production costs that have been observed to occur over the life of a product.

• There are two explanations for the experience effect:
  - Learning effects refer to cost savings that come from learning by doing.
  - Economies of scale refer to the reductions in unit cost achieved by producing a large volume of a product.

• The strategic significance of the experience curve is clear; moving down the experience curve allows a firm to reduce its cost of creating value and increase its profitability.
Leveraging Subsidiary Skills

- Leveraging the skills created within subsidiaries and applying them to other operations within the firm’s global network may create value.
- Learning how to leverage the skills of subsidiaries presents a challenge for managers of multinational organizations:
  - They must have the humility to recognize that valuable skills leading to competencies can arise anywhere within the firm’s global network.
  - They must establish an incentive system that encourages local employees to acquire new skills.
  - They must have a process for identifying when valuable new skills have been created in a subsidiary.
  - They need to act as facilitators, helping to transfer valuable skills within the firm.
Firms that compete in the global marketplace typically face two types of competitive pressure:

- Pressures for cost reductions
- Pressures to be locally responsive
Pressures for Cost Reductions

• International businesses often face pressures for cost reductions because of the competitive global market
• Pressures for cost reduction can be particularly intense in industries producing commodity-type products
  - Universal needs exist when the tastes and preferences of consumers in different nations are similar if not identical
• Pressures for cost reductions are also intense
  - In industries where major competitors are based in low-cost locations
  - Where there is persistent excess capacity
  - Where consumers are powerful and face low switching costs
Pressures for Local Responsiveness

• Differences in consumer tastes & preferences
  - North American families like pickup trucks while in Europe they are viewed as a utility vehicle for firms

• Differences in infrastructure & traditional practices
  - Consumer electrical system in North America is based on 110 volts; in Europe on 240 volts

• Differences in distribution channels
  - Germany has few retailers dominating the food market, while in Italy it is fragmented

• Host-Government demands
  - Health care system differences between countries require pharmaceutical firms to change operating procedures
Choosing a Strategy

- **Global Standardization Strategy** (High Pressures for Cost Reduction)
- **Transnational Strategy** (High Pressures for Local Responsiveness)
- **International Strategy** (Low Pressures for Local Responsiveness)
- **Localization Strategy** (Low Pressures for Cost Reduction)
The Evolution of Strategy

- The Achilles heel of the international strategy is that over time competitors inevitably emerge
  - An international strategy may not be viable in the long-term so firms need to shift toward a global standardization strategy or a transnational strategy in advance of competitors

- As competition intensifies
  - International and localization strategies tend to become less viable
  - Managers need to orient their companies toward either a global standardization strategy or a transnational strategy
The Evolution of Strategy

- **Global Standardization Strategy**
- **Transnational Strategy**
- **International Strategy**
- **Localization Strategy**

As competitors emerge, these strategies become less viable.

**Pressures for Cost Reductions**
- Low
- High

**Pressures for Local Responsiveness**
- Low
- High
Looking Ahead to Chapter 13

- The Organization of International Business
  - Organizational Architecture
  - Organizational Structure
  - Control Systems and Incentives
  - Processes
  - Organizational Culture
  - Synthesis: Strategy and Architecture
  - Organizational Change
International Strategy

- Create value by transferring valuable core competencies to foreign markets that indigenous competitors lack
- Centralize product development functions at home
- Establish manufacturing and marketing functions in local country but head office exercises tight control over it
- Limit customization of product offering and market strategy
  - Strategy effective if firm faces weak pressures for local responsive and cost reductions
Multidomestic Strategy

- Main aim is maximum local responsiveness
- Customize product offering, market strategy including production and R&D according to national conditions
- Generally unable to realize value from experience curve effects and location economies
- Possess high cost structure
Global Strategy

- Focus is on achieving a low cost strategy by reaping cost reductions that come from experience curve effects and location economies
- Production, marketing, and R&D concentrated in few favorable functions
- Market standardized product to keep costs low
- Effective where strong pressures for cost reductions and low demand for local responsiveness exist
  - Semiconductor industry
Transnational Strategy

• To meet competition, firms aim to reduce costs, transfer core competencies while paying attention to pressures for local responsiveness
• Global learning
  - Valuable skills can develop in any of the firm’s worldwide operations
  - Transfer of knowledge from foreign subsidiary to home country, to other foreign subsidiaries
• Transnational strategy difficult task due to contradictory demands placed on the organization
  - Caterpillar