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Global Strategies and the Multinational Corporation

Globalization has changed us into a company that searches the world, not just to sell or to source, but to find intellectual capital – the world's best talent and greatest ideas.

—JACK WELCH, FORMER CHAIRMAN, GENERAL ELECTRIC

OUTLINE

Introduction and Objectives

Internationalization is the most important and pervasive force reshaping the competitive environment of business. It has opened national markets to new competitors and created new business opportunities for both large and small firms. Internationalization occurs through two mechanisms: trade and direct investment. The growth of world trade has consistently outstripped the growth of world output, increasing export/sales and import penetration ratios for all countries and all industries. For the United States, the share of imports in sales of manufactured goods rose from less than 4% in 1960 to 29% in 2005. Trade in commercial services (transportation, communications, information, financial services, and the like) has grown even faster than merchandise trade. The scale of direct investment into the US is indicated by the fact that by 2006, the total stock of foreign direct investment by all companies was $11.7 trillion, compared with total US GDP of $12.8 trillion.[1]

The forces driving both trade and direct investment are, first, the quest to exploit market opportunities in other countries, and, second, the desire to exploit production opportunities by locating production activities wherever they can be conducted most efficiently. The resulting "globalization of business" has created vast flows of international transactions comprising payment for trade and services, flows of factor payments (interest, profits, and licensing fees), and flows of capital.

The implications for competition and industry structure are far reaching. During the 1960s, local companies dominated most domestic markets. Now the leaders in most industries are multinational players. Indeed overseas expansion is often viewed as a prerequisite for outstanding corporate success. For L'Oreal in cosmetics and toiletries, UBS and HSBC in banking, and McKinsey in consulting, international expansion has provided the foundation for profitability and growth. At the some time the risks too are great: for Saatchi & Saatchi in advertising, Daewoo in automobiles, and Marks & Spencer in retailing, overambitious internationalization marked the beginning of corporate decline.

For countries too, harnessing the forces of internationalization has been a prime determinant of relative economic performance. Within the European Union, Ireland's ability to take advantage of international trade and inward direct investment has resulted in real GDP per head increasing at an average annual rate of 7.6% during 1996–2006; Italy's increased a mere 1.3%.

This chapter examines the implications of the internationalization of the business environment for the formulation and implementation of company strategy. We will recognize that internationalization expands the market arena, bringing into competition firms with very different national resource bases, and making it possible for firms to access resources from outside their home country.

By the time you have completed this chapter, you will be able to:

- Use the tools of industry analysis to examine the impact of internationalization on industry structure and competition.
- Analyze the implications of a firm's national environment for its competitive advantage.
- Formulate strategies for exploiting overseas business opportunities, including overseas market entry strategies and overseas production strategies.
- Formulate international strategies that achieve an optimal balance between global integration and national differentiation.
- Design organizational structures and management systems appropriate to the pursuit of international strategies.

We begin by exploring the implications of international competition, first for industry analysis, and then for the analysis of competitive advantage.

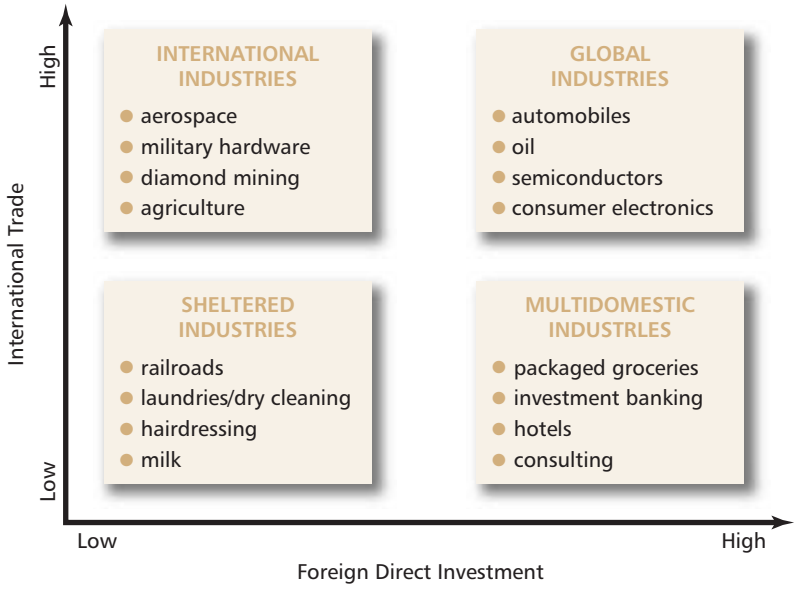
Implications of International Competition for Industry Analysis

Patterns of Internationalization

Internationalization occurs through *trade* – the sale and shipment of goods and services from one country to another – and *direct investment* – building or acquiring productive assets in another country. On this basis we can identify different types of industry according to the extent and mode of their internationalization (see Figure 14.1):

- *Sheltered industries* are served exclusively by indigenous firms. They are sheltered from international competition by regulation, public ownership, barriers to trade, or because the goods and services they offer are more suited to small local operators than to large, multiunit corporations. Industries left in this category are primarily fragmented service industries (dry cleaning, hairdressing, auto repair, funeral services), some small-scale manufacturing (handicrafts, homebuilding), and industries producing products that are nontradable because they are perishable (fresh milk, bread) or difficult to move (four-poster beds, garden sheds).
- *Trading industries* are those where internationalization occurs primarily through imports and exports. If a product is transportable, not nationally differentiated, and subject to substantial scale economies, exporting from a single location is the most efficient means to exploit overseas markets, which would apply for example with commercial aircraft, shipbuilding, and defense

FIGURE 14.1 Patterns of industry internationalization



equipment. Trading industries also include products whose inputs are available only in a few locations: diamonds from South Africa, caviar from Iran and Azerbaijan.

- *Multidomestic industries* are those that internationalize through direct investment – either because trade is not feasible (as in the case of service industries such as banking, consulting, or hotels) or because products are nationally differentiated (e.g., frozen dinners, recorded music).
- *Global industries* are those in which both trade and direct investment are important. Most large-scale manufacturing industries tend to evolve towards global structures: in automobiles, consumer electronics, semiconductors, pharmaceuticals, and beer, levels of trade and direct investment are high.

By which route does internationalization typically occur? In the case of services and other nontradable products, there is no choice. The only way that Marriott, Starbucks, and Goldman Sachs can serve overseas markets is by creating subsidiaries (or acquiring companies) within these markets. In the case of manufacturing companies, internationalization typically begins with exports – typically to countries with the least "psychic distance" from the home country. Later a sales and distribution subsidiary is established in the overseas country. Eventually the company develops a more integrated overseas subsidiary that undertakes manufacturing and product development as well.[2]

Implications for Competition

For the most part, internationalization means more competition and lower industry profitability. In 1976, the US automobile market was dominated by GM, Ford, and

Chrysler with 84% of the market. By 2006 there were 11 companies with auto plants within the US; the former "Big Three" accounted for just 46% of auto sales; and the industry was suffering from excess capacity, intense price competition, and massive losses.

The impact of internationalization on competition and industry profitability can be analyzed within the context of Porter's five forces of competition framework. For the purposes of our analysis, let us take our unit of analysis as national markets where the relevant "industry" comprises the firms supplying that national market.

Competition from Potential Entrants Barriers to entry into most national markets have fallen substantially. Tariff reductions, falling real costs of transportation, the removal of exchange controls, internationalization of standards, and convergence between customer preferences have made it much easier for producers in one country to supply customers in another. Many of the entry barriers that were effective against potential domestic entrants may be ineffective against potential entrants that are established producers in overseas countries.

Rivalry Among Existing Firms Internationalization increases internal rivalry within industries in three ways:

- *Lowering Seller Concentration*. International trade typically means that more suppliers are competing for each national market. I have already noted how the dominance of the US automobile industry by domestic producers has been destroyed by international competition. By 2006, there were nine manufacturers with market shares greater than 2%. In other countries and in other industries, the impact of internationalization has been similar. The European motor scooter industry was once dominated by the Italian firms Piaggio (Vespa scooters) and Lambretta. There are now ever 20 manufacturers supplying the European market. In addition to the Italians (Piaggio, Aprilia, Benelli), there are Japanese firms (Honda, Yamaha, Suzuki), Americans (Baron), Taiwanese (Kymco), Chinese (BenZhou/Yiying, Baotian, Kaitong/Yiben), and many more. Even in industries where global consolidation has been rapid (e.g. paper, telecoms, oil, airlines, and aluminum), Ghemawat and Ghadar show that global concentration has declined as a result of national producers entering the global market.[3]
- *Increasing Diversity of Competitors*. The increasing international diversity of competitors, implies differences in goals, strategies, and cost structures – all of which cause them to compete more vigorously while making cooperation more difficult.
- *Increasing Excess Capacity*. When internationalization occurs through direct investment, the result is likely to be increased capacity. To the extent that direct investment occurs through investment in new plants, industry capacity increases with no corresponding increase in market size. The automobile industry is a classic example of this – the investment by Japanese and Korean manufacturers in the US and Europe, and by US manufacturers in Latin America and Asia, added substantially to global excess capacity during the 1990s.

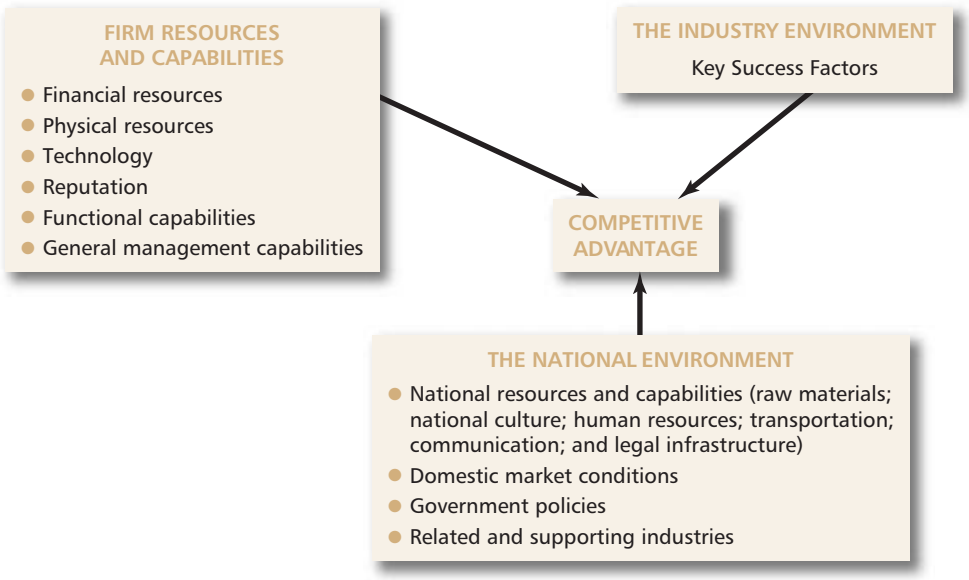
Increasing the Bargaining Power of Buyers A further implication of the internationalization of business is that large customers can exercise their buying power far more effectively. Global sourcing provides a key tool for cost reduction by manufacturers. The growth of internet-based markets for components and materials enhances the power of industrial buyers.

Analyzing Competitive Advantage in an International Context

The growth of international competition has been associated with some stunning reversals in the competitive positions of different companies. In 1986, US Steel was the world's biggest steel company; 20 years later, India-based Mittal Steel was global leader. In 1986, IBM and Apple were world market leaders in PCs. By 2006, IBM had exited the industry and Dell, HP, Lenovo, and Acer were the new leaders. In 1986, the world's biggest banks (by assets) were Deutsche Bank and Bank of Tokyo. By 2006, UBS and HSBC led the pack.

To understand how internationalization has shifted the basis of competition, we need to extend our framework for analyzing competitive advantage to include the influence of firms' national environments. Competitive advantage, we have noted, is achieved when a firm matches its internal strengths in resources and capabilities to the key success factors of the industry. International industries differ from domestic industries in their sources of competitive advantage. When firms are located in different countries, their potential for achieving competitive advantage depends not only on their internal stocks of resources and capabilities, but also on the conditions of their national environments – in particular, the resource availability within the countries where they do business. Figure 14.2 summarizes the implications of

FIGURE 14.2 Competitive advantage in an international context



internationalization for our basic strategy model in terms of the impact both on industry conditions and firms' access to resources and capabilities.

National Influences on Competitiveness: Comparative Advantage

The role of national resource availability on international competitiveness is the subject of the *theory of comparative advantage*. The theory states that a country has a comparative advantage in those products that make intensive use of those resources available in abundance within that country. Thus, Bangladesh has an abundant supply of unskilled labor. The United States has an abundant supply of technological resources: trained scientists and engineers, research facilities, and universities. Bangladesh has a comparative advantage in products that make intensive use of unskilled labor, such as clothing, handicrafts, leather goods, and assembly of consumer electronic products. The United States has a comparative advantage in technology-intensive products, such as microprocessors, computer software, pharmaceuticals, medical diagnostic equipment, and management consulting services.

The term comparative advantage refers to the *relative* efficiencies of producing different products. So long as exchange rates are well behaved (they do not deviate far from their purchasing power parity levels), then comparative advantage translates into competitive advantage. Hence, comparative advantages are revealed in trade performance. Table 14.1 shows revealed comparative advantages for several product groups and several countries. Positive values show comparative advantage; negative values show comparative disadvantage.

Trade theory initially emphasized the role of natural resource endowments, labor supply, and capital stock in determining comparative advantage. More recently emphasis has shifted to the central role of knowledge (including technology, human skills, and management capability) and the resources needed to commercialize knowledge (capital markets, communications facilities, and a legal system).[4] The remarkable economic development of the "tiger economies" of South Korea, Taiwan, Hong Kong, Malaysia, and Singapore demonstrates how disadvantages in endowments of natural resources are far outweighed by the development of these home-grown resources.[5]

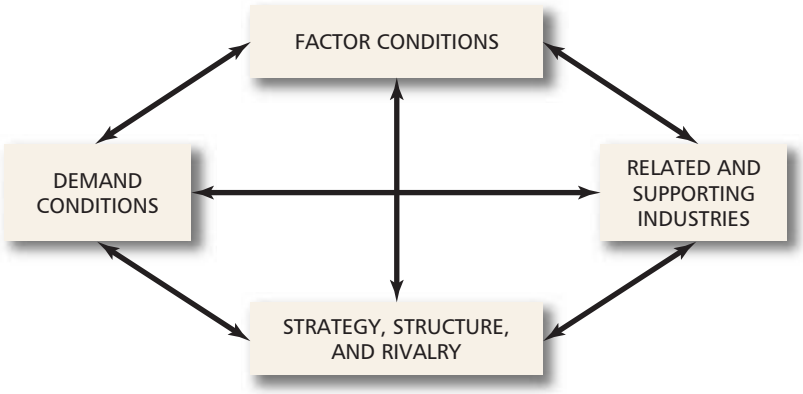
TABLE 14.1 Indexes of Revealed Comparative Advantage for Certain Broad Product Categories

	USA	Canada	Germany	Italy	Japan
Food, drink, and tobacco	0.31	0.28	−0.36	−0.29	−0.85
Raw materials	0.43	0.51	−0.55	−0.30	−0.88
Oil and refined products	−0.64	0.34	−0.72	−0.74	−0.99
Chemicals	0.42	−0.16	0.20	−0.06	−0.58
Machinery and transportation equipment	0.12	−0.19	0.34	0.22	0.80
Other manufacturing	−0.68	−0.07	0.01	0.29	0.40

Note: Revealed comparative advantage for each product group is measured as: (Exports less Imports)/Domestic Production.

SOURCE: OECD.

FIGURE 14.3 Porter's national diamond framework



A large home market facilitates the development and exploitation of capital, technology, and infrastructure. Hence, in most capital- and technology-intensive industries, large countries (such as the US) are at an advantage over small countries.[6] A similar logic motivates the creation of free trade areas such as the European Union, Mercosur, and NAFTA.

Porter's National Diamond

Michael Porter's has extended our understanding of comparative advantage by examining the dynamics through which specific industries in particular countries develop the resources and capabilities that confer international competitive advantage.[7] Porter's analysis is summarized in his national diamond framework (see Figure 14.3).[8]

Factor Conditions Whereas the conventional advantage of comparative analysis focuses on endowments of broad categories of resource, Porter's analysis emphasizes, first, "home-grown" resources and, second, the role of highly specialized resources. For example, in analyzing Hollywood's preeminence in film production, Porter points to the local concentration of skilled labor, including the roles of UCLA and USC schools of film. Also, resource constraints may encourage the development of substitute capabilities: in post-war Japan, raw material shortages spurred miniaturization and low-defect manufacturing; in Italy, restrictive labor laws have stimulated automation.

Related and Supporting Industries For many industries, a critical resource is the presence of related and supporting industries. One of the most striking of Porter's empirical findings is that national competitive strengths tend to be associated with "clusters" of industries. One such cluster is US strength in semiconductors, computers, and computer software. For each of these industries, critical resources are the other related industries. In Germany, a mutually supporting cluster exists around chemicals, synthetic dyes, textiles, and textile machinery.

Demand Conditions Demand conditions in the domestic market provide the primary driver of innovation and quality improvement. For example:

- The preeminence of Swiss watches may be attributed to the obsessive punctuality of the Swiss.
- The dominance of the world market for cameras by Japanese companies owes much to Japanese consumers' enthusiasm for amateur photography and their eager adoption of innovation in cameras.
- German companies' (Mercedes, BMW, Porsche) dominance of the high-performance segment of the world automobile industry, as compared with their much weaker position in mass-produced autos, may be linked to German motorists' love of quality engineering and their irrepressible urge to drive on autobahns at terrifying speeds.

Strategy, Structure, and Rivalry National competitive performance in particular sectors is inevitably related to the strategies and structures of firms in those industries. Porter puts particular emphasis on the role of intense domestic competition in driving innovation, efficiency, and the upgrading of competitive advantage. The success of the Japanese auto industry may reflect the presence of nine companies, all of which compete fiercely within the domestic market. The same can be said for cameras, consumer electronic products, and office machinery. Conversely, the weak position of European companies in many hi-tech industries may be a result of European governments' propensity to kill domestic competition by creating "national champions."

Consistency between Strategy and National Conditions

Establishing competitive advantage in global industries requires congruence between business strategy and the pattern of the country's comparative advantage. In audio equipment, it is sensible for Chinese producers, such as Dussun and Skyworth, to concentrate on the low end of the market and supplies to western mass retailers under their own brands. For Bose, international competitiveness requires exploiting US strengths in basic research. For Danish consumer electronics maker Bang & Olufsen, international competitiveness requires exploiting European strengths in design and high-end marketing. Japanese producers such as Sony and Matsuchita compete most effectively in the broad mid-market exploiting national strengths in consumer electronics and process technologies.

The linkage between the firm's competitive advantage and its national environment also includes the relationship between firms' organizational capabilities and the national culture and social structure. Stimulated by Max Weber's analysis of the impact of religion on enterprise,[9] national culture has been shown to exert a powerful influence on management practices in general and on the capability profiles of firms in particular. The capabilities of Japanese companies in integrating diverse technologies into innovative new products (electronic musical instruments, color copying machines), and in quality enhancement through continuous improvement, owes much to Japanese traditions of assimilating outside ideas and cooperative social behavior. Similarly, the excellence of US firms in financial services and pioneering new industries through entrepreneurship may link with US traditions of individualism and quest for material wealth. We shall return to the implications of national cultures for strategic management later in this chapter.

Applying the Framework: International Location of Production

To examine how national resource conditions influence international strategies, we look at two types of strategic decision in international business: first, the decision of where to locate production activities and, second, the decision of how to enter a foreign market. Let us begin with the first of these.

So far, our discussion of the linkage between the competitive advantage of the firm and its national environment has assumed, implicitly, that each firm is based within its home country. In fact, an important motive for internationalization is to access the resources and capabilities available in other countries. Traditionally, multinational companies either concentrated production in their home country or located manufacturing plants to serve each of the countries where they marketed their products. Increasingly, decisions as to where to produce are being separated over decisions as to where to sell. For example, the biggest markets for Motorola's wireless handsets are the US and EU, yet handset manufacture is primarily in China, Singapore, Malaysia, and Brazil.

Determinants of Geographical Location

The decision of where to manufacture requires consideration of three sets of factors:

- *National resource availability*. Where key resources differ between countries in their availability or cost, then firms should manufacture in countries where resource supplies are favorable. For the oil industry this means exploring in Kazakhstan, offshore Angola, and the Gulf of Mexico. For Nike and Reebok, it means locating shoe assembly where labor costs are low: China, Thailand, India, and the Philippines. (Table 14.2 shows differences in employment costs

TABLE 14.2 Hourly Compensation Costs in US Dollars for Production Workers in Manufacturing

	1975	1985	1995	2000	2005
United States	6.36	13.01	17.19	19.76	23.17
Mexico	1.47	1.59	1.51	2.08	2.50
Australia	5.62	8.20	15.27	14.47	23.09
Japan	3.00	6.34	23.82	22.27	21.90
Korea	0.32	1.23	7.29	8.19	11.52
Taiwan	0.40	1.50	5.94	5.85	5.97
Sri Lanka	0.28	0.28	0.48	0.48	0.54
France	4.52	7.52	20.01	15.70	23.89
Germany (former West)	6.31	9.53	31.58	24.42	34.05
Italy	4.67	7.63	16.22	14.01	20.48
Spain	2.53	4.66	12.88	10.78	17.10
Sweden	7.18	9.66	21.44	20.14	28.42
Switzerland	6.09	9.66	29.30	21.24	30.26
United Kingdom	3.37	6.27	13.67	16.45	24.71

SOURCE: US DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS

between countries.) For semiconductor and computer companies, it means establishing R&D facilities in California's Silicon Valley where there is the world's greatest concentration of microelectronics expertise.[10]

- *Firm-specific competitive advantages*. For firms whose competitive advantage is based on internal resources and capabilities, optimal location depends on where those resources and capabilities are situated and how mobile they are. Wal-Mart has experienced difficulty recreating its capabilities outside of the US. Conversely, Toyota and Goldman Sachs have successfully transferred their operational capabilities to their overseas subsidiaries.
- *Tradability*. The ability to locate production away from markets depends on the transportability of the product. Production within the local market is favored when transportation costs are high, local customers have differentiated preferences, and governments create barriers to trade. Services – hairdressing, medicine, and banking – need to be produced in close proximity to the customer. However, even with some services, communications technology permits remote production.

Location and the Value Chain

The production of most goods and services comprise a vertical chain of activities where the input requirements of each stage vary considerably. Hence, different countries offer differential advantage at different stages of the value chain. Table 14.3 shows the pattern of international specialization within textiles and apparel. Similarly with consumer electronics: component production is research and capital intensive and is concentrated in the US, Japan, Korea, and Taiwan; assembly is labor intensive and is concentrated in China, Thailand, and Latin America.

In principle, a firm can identify the resources required by each stage of the value chain, then determine which country offers these resources at the lowest cost.[11] For example, Nike locates R&D and design in the US; the production of fabric, rubber, and plastic shoe components in Korea, Taiwan, and China; and assembly in India, China, the Philippines, and Indonesia.[12]

However, when companies are making decisions to shift certain activities outside their home country – a process referred to as "*offshoring*" – it is important to look beyond comparisons of current costs and consider the underlying resources and capabilities available in different locations. Cost advantages are vulnerable to exchange

TABLE 14.3 Comparative Advantage in Textiles and Clothing by Vertical Stage

	Fiber production	Spun yarn	Textiles	Apparel
Hong Kong	−0.96	−0.81	−0.41	+0.75
Italy	−0.54	+0.18	+0.14	+0.72
Japan	−0.36	+0.48	+0.78	−0.48
USA	+0.96	+0.64	+0.22	−0.73

Notes:

1 Fiber production includes both natural and synthetic fibers.

2 Revealed comparative advantage is measured as (Exports – Imports) / (Exports + Imports).

SOURCE: UNITED NATIONS

rate changes and wage inflation. Moreover, noncost aspects of operational performance may ultimately be more important:

> *[W]estern companies are finding that offshoring locations such as China and India offer access to world-class skills. For example, Jim Breyer, managing partner of Accel Partners, a Silicon Valley venture capitalist, observed: "Taiwan and China have some of the world's best designers of wireless chips and wireless software." In certain types of precision manufacturing, including the processes that produce magnesium alloy casing for notebook computers, companies such as Waffer in Taiwan offer some of the most sophisticated technology in the world.*
>
> *Most of the leading Indian IT outsourcing companies operate at level 5 – the highest level of expertise – of the Capability Maturity Model (CMM), an international measure of technical skill, while most internal IT departments in western companies operate at level 2 or 3. Call centres, such as those operated by eTelecare – a Manila-based outsourcing provider – offer better average handling times and customer satisfaction relative to leading companies in the US.*[13]

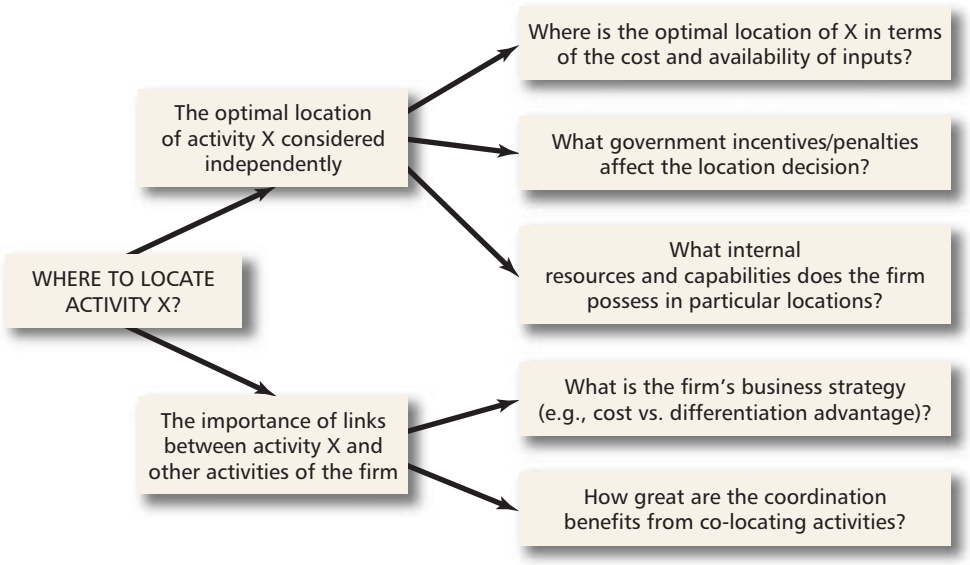
In the highly fragmented value chains of most electronic products, technology, know-how, and speed are as important as cost in determining where different activities are located (see Table 14.4).

TABLE 14.4 Global Production: The Hewlett Packard Pavilion 8000 Laptop Computer

Component/Process	Provider and Location
Design	HP, California; also, HP design studios in Taiwan and China collaborate with third-party manufacturers
Assembly	Contracted to Quanta (Taiwan); assembled in China by Quanta and by third-party contractors
Microprocessor	Designed by Intel in California; manufactured at Intel plants in Oregon, New Mexico, and Israel
Graphics card	Designed by ATI Technologies in Canada; manufactured in Taiwan
Screen	Manufactured by LG Philips LCD Co. (a joint venture between LG of Korea and Philips of the Netherlands). Manufactured in South Korea
Hard disk drive	By Seagate. Designed in California; manufactured in Malaysia
Lithium ion battery	Manufactured by Sony in Japan
Logistics	Contracted to 40 third-party providers (some global, such as Federal Express, DHL, and TNT; others local)
Telephone sales and customer support	Contracted to third-party providers in Canada, UK, Ireland, and India

SOURCES: WWW.HP.COM; "THE LAPTOP TRAIL" *WALL STREET JOURNAL* (JUNE 9, 2005).

FIGURE 14.4 Determining the optimal location of value chain activities



The benefits from fragmenting the value chain must be traded off against the added costs of coordinating globally dispersed activities. Transportation costs are one consideration. Another is increased inventory cost. Increased time can be the most costly consequence of dispersed activities. Just-in-time scheduling often necessitates that production activities are carried out in close proximity to one another. Although the labor cost of building an automobile in Mexico is only 20% of the labor cost in the US, this cost advantage of Mexican production is almost entirely offset by higher costs of components. The tradeoff between cost and time depends on the strategy of the company. Companies that compete on speed and reliability of delivery (e.g. Zara and Dell Computer) typically forsake the cost advantages of a globally dispersed value chain in favor of integrated operations with fast access to the final market.

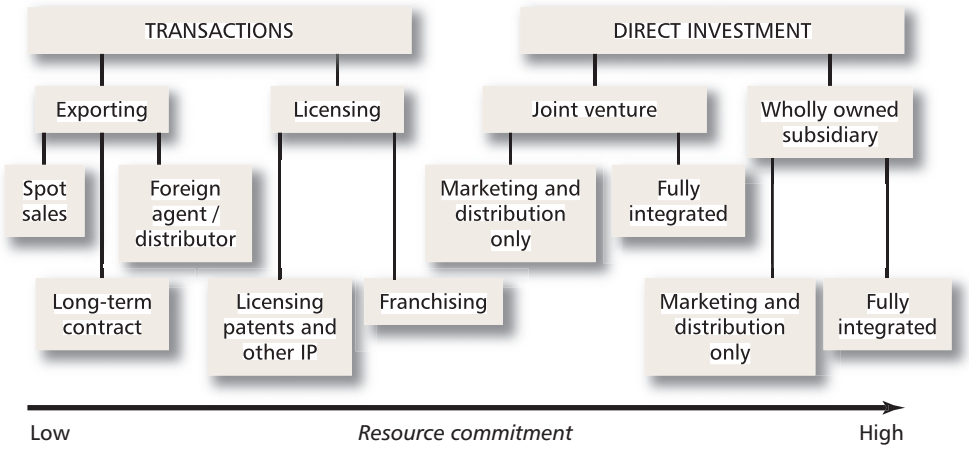
Figure 14.4 summarizes the relevant criteria in location decisions.

Applying the Framework: Foreign Entry Strategies

Many of the considerations relevant to locating production activities also apply to choosing the mode of foreign market entry. A firm enters an overseas market because it believes that it will be profitable. This assumes not only that the overseas market is attractive – that its structure is conducive to profitability – but also that the firm can establish a competitive advantage vis-à-vis local producers and other multinational corporations (MNCs). We discussed the analysis of industry and market profitability in Chapters 3 and 4. Our focus here is on how the firm can best establish competitive advantage in a foreign market.

In exploiting an overseas market opportunity, a firm has a range of options with regard to mode of entry. These correspond closely to the firm's strategic alternatives with regard to exploiting innovation (see Chapter 11). The basic distinction is

FIGURE 14.5 Alternative modes of overseas market entry



between market entry by means of *transactions* and market entry by means of *direct investment*. Figure 14.5 shows a spectrum of market entry options arranged according to the degree of commitment by the firm. Thus, at one extreme there is exporting through individual spot-market transactions; at the other, there is the establishment of a fully owned subsidiary that undertakes a full range of functions.

How does a firm weigh the merits of different market entry modes? Five key issues are relevant.

1. Is the firm's competitive advantage based on firm-specific or country-specific resources? If the firm's competitive advantage is country based, the firm must exploit an overseas market by exporting. Thus, to the extent that Hyundai's competitive advantage in the US car market is its low domestic cost base, it must produce in Korea and export to the United States. If Toyota's competitive advantage is company specific, then assuming that advantage is transferable within the company, Toyota can exploit the US market either by exports or by direct investment in US production facilities.[14]

2. Is the product tradable and what are the barriers to trade? If the product is not tradable because of transportation constraints or import restrictions, then accessing that market requires entry either by investing in overseas production facilities or by licensing the use of key resources to local companies within the overseas market.

3. Does the firm possess the full range of resources and capabilities for establishing a competitive advantage in the overseas market? Competing in an overseas market is likely to require that the firm acquires additional resources and capabilities, particularly those related to marketing and distributing in an unfamiliar market. Accessing such country-specific resources is most easily achieved by establishing a relationship with firms in the overseas market. The form of relationship depends, in part, on the resources and capabilities required. If a firm needs marketing and distribution, it might appoint a distributor or agent with exclusive territorial

rights. If a wide range of manufacturing and marketing capabilities is needed, the firm might license its product and/or its technology to a local manufacturer. In technology-based industries, licensing technology to local companies is common. In marketing-intensive industries, firms with strong brands can license their trademarks to local companies. Alternatively, a joint venture might be sought with a local manufacturing company. US companies entered the Japanese market by joint ventures with local companies (e.g., Fuji–Xerox, Caterpillar–Mitsubishi). These combined the technology and brand names of the US partner with the market knowledge and manufacturing and distribution facilities of the Japanese firm.

4. Can the firm directly appropriate the returns to its resources? Whether a firm licenses the use of its resources or chooses to exploit them directly (either through exporting or direct investment) depends partly on appropriability considerations. In chemicals and pharmaceuticals, the patents protecting product innovations tend to offer strong legal protection, in which case patent licenses to local producers can be an effective means of appropriating their returns. In computer software and computer equipment, the protection offered by patents and copyrights is looser, which encourages exporting rather than licensing as a means of exploiting overseas markets.

With all licensing arrangements, key considerations are the capabilities and reliability of the local licensee. This is particularly important in licensing brand names, where the licenser must carefully protect the brand's reputation. Thus, Cadbury-Schweppes licenses to Hershey the trademarks and product recipes for its Cadbury's range of chocolate bars for sale in the United States. This arrangement reflects the fact that Hershey has production and distribution facilities in the US that Cadbury cannot match, and that Cadbury views Hershey as a reliable business partner.

5. What transaction costs are involved? A key issue that arises in the licensing of a firm's trademarks or technology concerns the transaction costs of negotiating, monitoring, and enforcing the terms of such agreements as compared with internationalization through a fully owned subsidiary. In expanding overseas, Starbucks owns and operates its coffee houses while McDonald's franchises its burger restaurants. McDonald's competitive advantage depends primarily upon the franchisee faithfully replicating the McDonald's system. This can be enforced effectively by means of franchise contracts. Starbucks believes that its success is achieved through creating the "Starbucks experience" which is as much about ambiance as it is about coffee. It is difficult to articulate the ingredients of this experience, let alone write it into a contract.

Issues of transaction costs are fundamental to the choices between alternative market entry modes. Barriers to exporting in the form of transport costs and tariffs are forms of transaction costs; other costs include exchange rate risk and information costs. Transaction cost analysis has been central to theories of the existence of multinational corporations. In the absence of transaction costs in the markets either for goods or for resources, companies exploit overseas markets either by exporting their goods and services or by selling the use of their resources to local firms in the overseas markets.[15] Thus, multinationals tend to predominate in industries where:

- firm-specific intangible resources such as brands and technology are important (transaction costs in licensing the use of these resources favor direct investment);

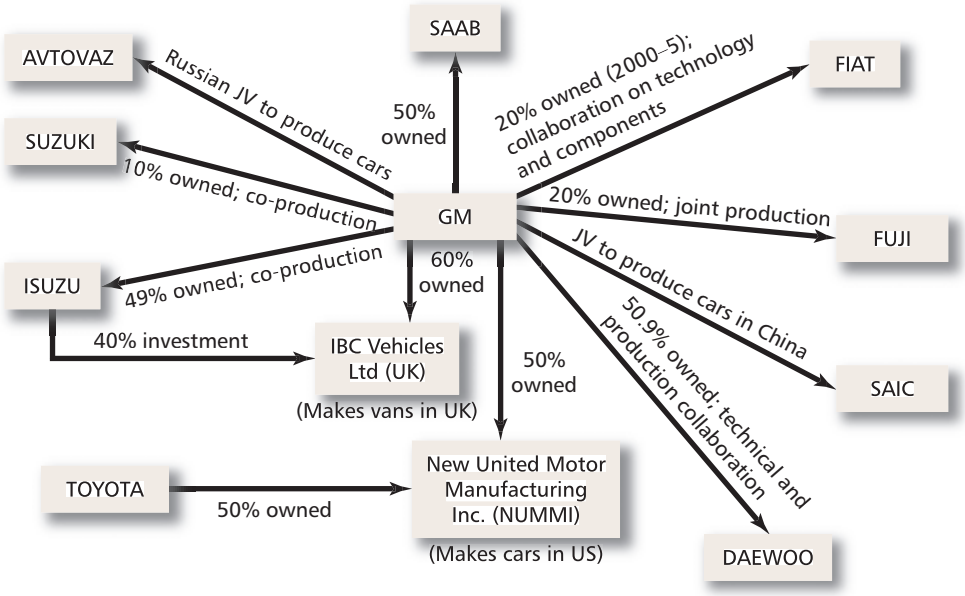
- exporting is subject to transaction costs (e.g., through tariffs or import restrictions);
- customer preferences are reasonably similar between countries.

International Alliances and Joint Ventures

During the past decade and a half, one of the most striking features of the development of international business has been the upsurge in the numbers of joint ventures and other forms of strategic alliance across national borders. For the Russian gas giant, Gazprom, alliances are the principal vehicle for Gazprom establishing a global presence. Gazprom is involved in pipeline alliances with Eni (Italy), CNPC (China), EON (Germany), PDVSA (Venezuela), and MOL (Hungary). It collaborates with Petrocanada and Sonotrach (Algeria) on liquefied natural gas. General Motors is another company that has used alliances to access markets, share technology, and exploit economies of size. Figure 14.6 shows GM's network of alliances with other automakers.

The traditional reason for cross-border alliances and joint ventures was the desire by multinational companies to access the market knowledge and distribution capabilities of a local company, together with the desire by local companies to access the technology, brands, and product development of the multinationals. Western banks entering China's booming credit card market have usually formed marketing alliances with local banks, often reinforced with an equity stake.[16] Host governments in China, India, and other emerging market countries often oblige foreign companies to take a local partner. In technology-based industries – computers, semiconductors, telecom

FIGURE 14.6 General Motors' Alliances with Competitors



SOURCES: WWW.GM.COM; WWW.WIKIPEDIA.ORG

equipment, pharmaceuticals, and aerospace – the rapid growth of international collaboration reflects companies' desire to access other companies' different technological capabilities and to speed the global rollout of new products. In the energy sector, and other capital-intensive industries, joint ventures are important for sharing risks.

The success of cross-border joint ventures and other forms of international strategic alliance has been mixed. The Sony–Ericsson mobile phone joint venture, the Renault–Nissan alliance, and HP and Canon's collaboration in printers have been successes. BT and AT&T's Concert alliance, the GM–Fiat alliance, and Swissair's alliance network were all disasters. Joint ventures that share management responsibility are far more likely to fail than those with a dominant parent or with independent management.[17] The greatest problems arise between firms that are also competitors: reconciling cooperation with competition is a challenge for executives who lack the strategic insight or tolerance for ambiguity possessed by Bismark or Metternich.

Disagreements over the sharing of the contributions to and returns from an alliance are a frequent source of friction. When each partner seeks to access the other's capabilities, "competition for competence" results.[18] In several of the alliances between Japanese and western firms, the Japanese partner was better at appropriating the benefits of the alliance.[19] However, in long-term partnerships there is the potential for the benefits to flow in both directions. When Xerox Corporation ran into problems during the 1990s, it was saved by technology, product designs, and management techniques from its Japanese joint venture Fuji–Xerox.[20]

The effective strategic management of international alliances, argue Hamel, Doz, and Prahalad, depends on a clear recognition that collaboration is competition in a different form.[21] They argue that how the alliance benefits are shared depends on three key factors:

- *The strategic intent of the partners*. The clearer a firm is about its strategic goals in entering an alliance, the more likely it is to achieve a positive result from the alliance. One of the problems of GM's network of alliances with foreign automakers was the lack of a coherent view of how each alliance fitted with GM's overall strategy.
- *Appropriability of the contribution*. The ability of each partner to capture and appropriate the skills of the other depends on the nature of each firm's skills and resources. Where skills and resources are tangible or explicit, they can easily be acquired. Where they are tacit and people embodied, they are more difficult to acquire. To avoid the unintended transfer of know-how to partners, Hamel et al. argue the need for a "gatekeeper" to monitor and administer contacts with strategic partners.
- *Receptivity of the company*. The more receptive a company is in terms of its ability to identify what it wants from the partner, to obtain the required knowledge or skills, and to assimilate and adapt them, the more it will gain from the partnership. In management terms, this requires the setting of performance goals for what the partnership is to achieve for the company and managing the relationship to ensure that the company is deriving maximum learning from the collaboration.[22] When a firm has a portfolio of alliances, a systematic approach to monitoring and performance evaluation is especially important.[23]

Multinational Strategies: Globalization versus National Differentiation

So far, we have viewed international expansion, whether by export or by direct investment, as a means by which a company can exploit its competitive advantages not just in its home market but also in foreign markets. However, international scope may itself be a source of competitive advantage over geographically focused competitors. In this section, we explore whether, and under what conditions, firms that operate on an international basis are able to gain a competitive advantage over nationally focused firms. If such "global strategies" have potential for creating competitive advantage, in what types of industry are they likely to be most effective? And how should they be designed and deployed in order to maximize their potential?

The Benefits of a Global Strategy

A global strategy is one that views the world as a single, if segmented, market. The late Ted Levitt argued that companies that compete on a national basis are highly vulnerable to companies that compete on a global basis.[24] The superiority of global strategies rests on two assumptions:

- *Globalization of customer preferences*. National and regional preferences are disappearing in the face of the homogenizing forces of technology, communication, and travel. "Everywhere everything gets more and more like everything else as the world's preference structure is relentlessly homogenized," observed Levitt. Nor is this trend restricted to technology-based products such as pharmaceuticals and computers; it is just as prevalent in branded consumer goods such as Corona beer, Adidas sportswear, and McDonald's hamburgers.
- *Scale economies*. Firms that produce for the world market can access scale economies in product development, manufacturing, and marketing that offer efficiency advantages that nationally based competitors cannot match pharmaceuticals, consumer electronics, and investment banking, few nationally focused firms have survived competition from global players.

Subsequent contributions to the analysis of global strategy points to benefits in addition to scale economies.[25] There are five major benefits from a global strategy:

Cost Benefits: Scale and Replication Levitt concentrated on the scale advantages of global operation. In most global industries, the most important source of scale economy is product development.

However, for most internationalizing firms, the major cost advantage from multinational operation derives from economies in the replication of knowledge-based assets – including organizational capabilities.[26] When a company has created a knowledge-based asset or product – whether a recipe, or a piece of software, or an organizational system – creating the original knowledge was costly but, once created, subsequent replication is typically cheap. Thus, once Disney has built Disneyland, Anaheim and Walt Disney World in Florida, a Disneyland theme park in Paris or Hong Kong can be built at a fraction of the cost. Similarly with McDonald's: its business system was built in the US over several decades. Once created, the incremental cost of replicating the system in another country is comparatively small.

Exploiting National Resources Differences Global strategy does not necessarily involve production in one location and then distributing globally. Global strategies also involve exploiting the efficiencies from locating different activities in different places. As we have seen, companies internationalize not just in search of market opportunities but also in search of resource opportunities. Traditionally this has meant a quest for raw materials and low-cost labor. Increasingly it means a quest for knowledge. For example, in the semiconductor industry, overseas subsidiaries are set up primarily to access knowledge in the host country rather than to exploit their existing knowledge.[27]

Serving Global Customers In several industries – investment banking, audit services, advertising – the primarily driver of globalization has been the need to service global customers. Thus, the internationalization of auto parts manufacturers has tended to follow the internationalization patterns of the auto assemblers.

Learning Benefits If competitive advantage involves innovation and the constant deepening and widening of capabilities, then learning plays a central role in developing and sustaining competitive advantage. If learning involves communicating and interacting with one's proximate environment, then multinationals have the advantage of working within multiple national environments. The critical requirement is that the company possesses some form of global infrastructure for communication and knowledge transfer that permits new experiences, new ideas, and new practices to be transferred and integrated. A growing stream of research suggests that the most important advantage of multinationals over domestic companies is their ability to access knowledge in multiple locations, to synthesize that knowledge, and to transfer it efficiently across national borders.[28]

Competing Strategically A major advantage of the Romans over the Gauls, Goths, and other barbarian tribes, was the Romans' ability to draw upon the military and economic resources of the Roman Empire to fight local wars. Similarly, multinational companies possess a key strategic advantage over their nationally focused competitors: multinationals can fight aggressive competitive battles in individual national markets using their cash flows from other national markets. At its most simple, this *cross-subsidization* of competitive initiatives in one market using profits from other markets involves *predatory pricing* – cutting prices to a level that drives competitors out of business. Such pricing practices are likely to contravene both the World Trade Organization's antidumping rules and national antitrust laws. More usually, cross-subsidization involves using cash flows from other markets to finance aggressive sales and marketing campaigns.[29] Thus, Japanese, Korean, and Taiwanese electronics firms financed their expansion in US markets with profits from their domestic businesses.[30]

Strategic competition between MNCs presents more complex opportunities for attack, retaliation, and containment.[31] The most effective response to competition in one's home market may be to retaliate in the foreign MNC's own home market. Fuji Film's incursion into Kodak's backyard was symbolized by Fuji's sponsorship of the 1984 Olympic Games in Los Angeles. Kodak responded by attacking Fuji in Japan.[32] To effectively exploit such opportunities for national leveraging, some overall global coordination of competitive strategies in individual national markets is required.

In industries that are dominated by MNCs – automobiles, semiconductors and investment banking – conventional wisdom has been that companies should seek to

position themselves in all three of the world's major industrial centers: North America, Europe, and Japan. Thus, in automobiles Daimler-Benz acquired Chrysler in the US and Mitsubishi in Japan. Ford and GM augmented their strong positions in the US and Europe with equity stakes in Japanese companies. McKinsey's Kenichi Ohmae, argues the case for *triad power* – that the need to access technology, develop customer preferences, and scale economies requires global players to become true insiders within all of the world's big three: the US, Europe, and Japan.[33]

The Need for National Differentiation

For all the advantages of global strategy, the evidence of the past decade is that national differences in customer preferences continue to exert a powerful influence in most markets: products designed to meet the needs of the "global customer" tend to be unappealing to most consumers. Moreover, costs of national differentiation can be surprisingly low if common basic designs and common major components are used. Most auto firms have abandoned attempts to create global car models in favor of common platforms.[34] Flexible manufacturing systems have reduced the costs of customizing products to meet the preferences of particular customer groups.

Domestic appliances provide an interesting refutation of the globalization hypothesis. In washing machines, national preferences have shown remarkable resilience: French and US washing machines are primarily top loading, elsewhere in Europe they are mainly front loading; the Germans prefer higher spin speeds than the Italians; US machines feature agitators rather than revolving drums; and Japanese machines are small. In domestic appliances, the pioneers of globalization, such as Electrolux and Whirlpool, have been outperformed by some national and regional specialists.[35]

Similarly in banking: most of the world's most profitable banks – US Bancorp, Bank of China, National Bank of Kuwait, and Anglo Irish Bank – are national rather than global players.

Apart from customer demand, several other factors encourage national differentiation:

- *Laws and government regulations*. Governments are the most important sources of obstacles to globalization. Legal and regulatory conditions create distinct national markets in financial services, pharmaceuticals and health services, alcoholic beverages, and telecommunications.
- *Distribution channels*. Differences between the distribution systems of different countries are among the biggest barriers to global marketing strategies. Procter & Gamble must adapt its marketing, promotion, and distribution of toiletries and household products to take account of the fact that, in the US, a few chains account for a major share of its US sales; in southern Europe, most sales are through small, independent retailers; while in Japan, P&G must sell through a multitiered hierarchy of distributors.
- *Presence of lead countries*. Countries differ in their levels of sophistication and acceptance of innovation on a product-by-product basis. For consumer products, Japan is the lead market; for computer hardware and software and financial services, the US is the lead market; for automobile technology and design, Europe tends to lead; for mobile telecommunications, South Korea has moved into the lead. These differences in market progressiveness encourage a sequential approach to global strategy in which products are introduced first in the lead market, followed by a global rollout. Sequential

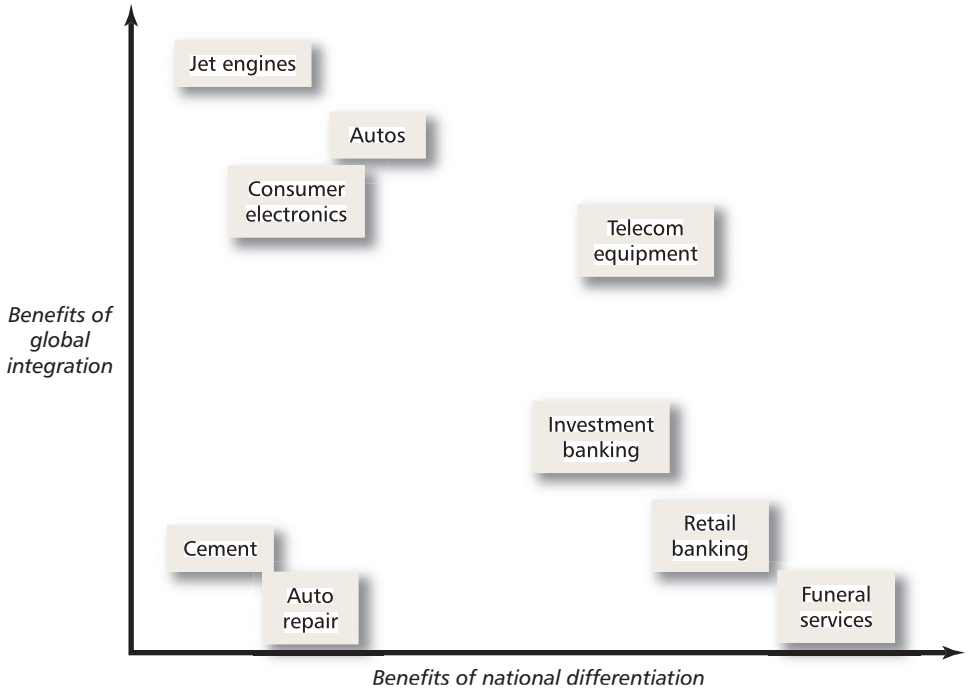
product launches allow firms to learn from experiences in the lead market and exploit that learning in subsequent country launches.

- *National cultures*. Underlying differences between countries in customer preferences and business methods are typically the result of differences in national cultures. Culture comprises assumptions, values, traditions, and behavioral norms. At its most general, culture may be described as a shared system of meaning within a group or society. Many of the problems of international expansion encountered by companies – from Wal-Mart in Germany and Korea, Disney with EuroDisneyland, and Marks & Spencer in Europe and North America – can be linked to problems of cultural adjustment. The need to adapt to local cultures may influence the mode of internationalization chosen. Franchising is an attractive international expansion strategy for service businesses because it utilizes the knowledge and cultural identity of local partners. In outsourcing production, customer support and administrative functions to Asia, most western companies have relied on contracts with local firms rather than face the cultural challenges of establishing their own overseas units. Strategy Capsule 14.1 examines differences in national cultures.

Reconciling Global Integration with National Differentiation

Choices about internationalization strategy have been viewed as a tradeoff between the benefits of global integration and those of national adaptation (see Figure 14.7).

FIGURE 14.7 Benefits of Global Integration versus National Differentiation



STRATEGY CAPSULE 14.1

How do National Cultures Differ?

Do people differ between countries with regard to beliefs, norms and value systems? The answer from a series of research studies is "yes."

The best known study of national cultural differences is by Geert Hofstede. The principal dimensions of national values he identified were:

- *Power Distance* – the extent to which inequality, decision-making power in particular, is accepted within organizations and within society. Power distance was high in Malaysia, and most Latin American and Arab countries; low in Austria and Scandinavia.
- *Uncertainty avoidance*. Preference for certainty and established norms was high in most southern European and Latin American countries; tolerance for uncertainty and ambiguity were high in Singapore, Sweden, UK, US, and India.
- *Individualism*. Concern for individual over group interests was highest in the US, UK, Canada, and Australia. Identification with groups and the collective interest was strongest in Latin America and Asia (especially Indonesia, Pakistan, Taiwan, and South Korea).
- *Masulinity/Feminitiy*. Hofstede identifies emphasis on work and material goals and demarcation of gender roles as "masculine"; emphasis on personal relationships rather than efficiency and belief in gender equality was viewed as "feminine." Japan, Austria, Venezuela, and Italy scored high on masculinity; Scandinavia and the Netherlands scored very low.

Other studies have used different measures for characterizing national cultures. Fons Trompenaars (another Dutchman) emphasizes "universalism" versus "particularism" in outlook (the US and Australia score highest on universalism); "neutral" versus "affective" relationships (Japan and UK are highest in terms of neutrality; Mexico and the Netherlands the most affective); and achievement orientation (Australia and US very high; Venezuela, Indonesia, and China very low).

Sources: G. Hofestede, *Culture's Consequences: International Differences in Work-related Values* (Thousand Oaks, CA: Sage, 1984); F. Trompenaars, *Riding the Waves of Culture* (London: Economist Books, 1993).

Industries where scale economies are huge and customer preferences homogeneous call for a global strategy (e.g. jet engines). Industries where national preferences are pronounced and where customization is not prohibitively expensive favor a "multidomestic" strategy (e.g. retail banking). Indeed, if there are no significant benefits from global integration, then we may see these industries supplied almost entirely by locally specialized firms (as in funeral services and hairdressing). However, some industries may be low on most dimensions – cement and car repair services are fairly homogeneous worldwide, but also lack significant scale economies or other major benefits from global presence. Conversely, other industries offer substantial benefits

from operating at global scale (telecommunications equipment, military hardware), but national preferences and standards may also necessitate considerable adaptation to the needs of specific national markets.

Reconciling conflicting forces for global efficiency and national differentiation represents one of the greatest strategic challenges facing MNCs. Achieving what Sony's former chairman described as "global localization"[36] involves standardizing product features and company activities where scale economies are substantial and differentiating where national preferences are strongest and where achieving them is not over-costly. Thus, a global car such as the Honda Civic (introduced in 1972 and sold in 110 countries of the world) now embodies considerable local adaptations – not just to meet national safety and environmental standards, but also to meet local preferences for leg room, seat specifications, accessories, color, and trim. McDonald's too makes considerable efforts to mesh global standardization with local adaptation (see Strategy Capsule 14.2).

STRATEGY CAPSULE 14.2

McDonald's Goes Glocal

For antiglobalization activists, McDonald's is a demon of globalization: it crushes national cuisines and small, traditional family businesses with the juggernaut of US fast-food corporate imperialism. In reality, McDonald's global strategy is a careful blend of global standardization and local adaptation.

McDonald's menus include a number of globally standardized items – the Big Mac and potato fries are international features – however, in most countries McDonald's menus feature an increasing number of locally developed items. These include:

- Australia – Roast Beef and BBQ Sauce Deli Sandwich; Chicken Tandoori Sandwich
- France – Croque McDo; McCroissant
- Hong Kong – Star-shaped Hash Browns; Rice Burgers; Plum Drink with Aloe Vera
- India – McVeggie Burger; McAloo Tikka Burger; Veg Pizza McPuff
- Saudi Arabia – McArabia Kofta; McArabia Chicken
- Switzerland – Shrimp Cocktail; Chickenburger Curry
- UK – Oat-So-Simple Porridge; Toasted Deli Sandwiches
- US – Tortilla Wraps; premium salad range.

There are differences too in restaurant decor, service offerings (internet access in the UK; home delivery in India), and market positioning (McDonald's tends to have a more upmarket positioning outside the US). In Israel many McDonald's are kosher – they do not offer dairy products and are closed on Saturdays. In India neither beef nor pork is served. A key reason that almost all of McDonald's non-US outlets are franchised is to facilitate adaptation to national environments and access to local know-how.

Yet, the principal features of the McDonald's business system are identical throughout the world. McDonald's values and business principles are seen as universal and invariant. Its emphasis on families and children is intended

to identify McDonald's with fun and family life wherever it does business. Community involvement and the Ronald McDonald children's charity are also worldwide. Corporate trademarks and brands are mostly globally uniform – including the golden arches logo and "I'm lovin' it" tag line. The business system itself – the franchising, the training of managers and franchisees through Hamburger University, restaurant operations, and supplier relations – is also highly standardized.

Traditionally, McDonald's international strategy was about adapting its US model to local conditions. Increasingly McDonald's is using local differentiation as a basis for worldwide adaptation and innovation through transferring new menu items and business concepts from one country to another. For example, the McCafe gourmet coffeehouses within McDonald's restaurants were first developed in Australia. By 2003, McCafes had become established in 30 countries, including the US. In responding to the growing tide of concern over nutrition and obesity in the developed world, McDonald's has drawn upon country initiatives with regard to sandwiches, salads and information labeling as a basis for global learning.

Whether or not McDonald's has the balance right between global standardization and local adaptation is open to debate. Simon Anholt, a British marketing expert, argues: "By putting local food on the menu, all you are doing is removing the logic of the brand, because this is an American brand. If McDonald's serves what you think is a poor imitation of your local cuisine, it's going to be an insult." But according to McDonald's CEO Jim Skinner: "We don't run our business from Oak Brook. We are a local business with a local face in each country we operate in." His chief marketing manager, Mary Dillon adds: "McDonald's is much more about local relevance than a global archetype. Globally we think of ourselves as the custodian of the brand, but it's all about local relevance."

Sources: www.mcdonalds.com; *McDonald's Localization Strategy: Brand Unification, Menu Diversification?* ICFAI Case Study 306-316-1 (2006).

Reconciling global efficiency with appealing to customer preferences in each country also means looking at the globalization/national differentiation tradeoff for individual products and individual function. In the banking industry, different products and services have different potential for globalization. Credit cards and basic savings products such as certificates of deposit tend to be globally standardized; checking accounts and mortgage lending are much more nationally differentiated. Some of the most successful international banks are those that have specialized in more global products and services – for example, Capital One and MBNA in credit cards; UBS in private banking for affluent individuals.

Different functions also have different positioning with regard to global integration and national differentiation. R&D, purchasing, IT, and manufacturing have strong globalization potential because of scale economies; sales, marketing, customer service, and human resource management tend to require much more national differentiation. These differences have important implications for how the MNC is organized.

Strategy and Organization within the Multinational Corporation

Managing business activities that cross national frontiers is complex. As a result, the success of international strategies depends critically on the effectiveness with which they are implemented. One of the greatest challenges facing the senior managers of MNCs is aligning organizational structures and management systems and their fit with the strategies being pursued.

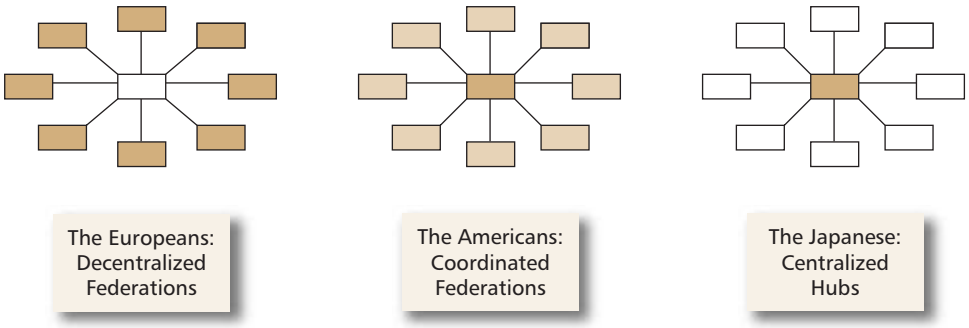
The Evolution of Multinational Strategies and Structures

All companies are subject to organizational inertia. MNCs, because of their complexity, face particular difficulty in adapting quickly to external change. As a result, established MNCs are captives of their history: the strategy–structure configurations adopted by today's MNCs reflect the choices they made at the time of their international expansion. Radical changes in strategy and structure are difficult: once an international distribution of functions, operations, and decision-making authority has been determined, reorganization is slow, difficult, and costly – particularly when host governments become involved. Bartlett and Ghoshal argue that this "administrative heritage" of an MNC – its configuration of assets and capabilities, its distribution of managerial responsibilities, and its network of relationships – constrains its ability to build new strategic capabilities.[37]

Leadership in the internationalization of business has been held by companies from different counties at different times. Bartlett and Ghoshal identify three eras (see Figure 14.8). For the companies of each era, their management challenges today are still shaped by their historical experiences.

- *Early 20th century: Era of the European multinational*. European companies such as Unilever, Shell, ICI, and Philips were pioneers of multinational expansion. Because of the conditions at the time of internationalization –

FIGURE 14.8 The development of the multinational corporation: alternative parent–subsidiaries relations



Note: The density of shading indicates the concentration of decision making.

poor transportation and communications, highly differentiated national markets – the companies created "multinational federations": each national subsidiary was operationally autonomous and undertook the full range of function, including product development, manufacturing, and marketing.

- *Post-World War II: Era of the American multinational*. US economic dominance was the basis for the preeminence of US multinationals such as GM, Ford, IBM, Coca-Cola, Caterpillar, Gillette, and Procter & Gamble. While their overseas subsidiaries were allowed considerable autonomy, this was within the context of the dominant position of their US parent in terms of capital, new product and process technology, management capabilities, and management systems. US-based resources and capabilities were their primary competitive advantages in world markets.
- *The 1970s and 1980s: The Japanese challenge*. Japanese MNCs – Honda, Toyota, Matsushita, NEC, and YKK – pursued global strategies from centralized domestic bases. R&D and manufacturing were concentrated in Japan; overseas subsidiaries were primarily sales and distribution units. Globally standardized products manufactured in large-scale plants provided the basis for unrivalled cost and quality advantages. Over time, manufacturing and R&D was dispersed – initially because of trade protection by consumer countries and a rising value of the yen against other currencies.

The different administrative heritage of these different groups of MNCs continues to shape their organizational capabilities today. The strength of European multinationals is adaptation to the conditions and requirements of individual national markets. The strength of the US multinationals is their ability to transfer technology and proven new products from their domestic strongholds to their national subsidiaries. That of the Japanese MNCs is the efficiency of global production and new product development. Yet, these core capabilities are also core rigidities. The challenge for European MNCs has been to achieve greater integration of their sprawling international empires – for Shell and Philips this has involved reorganizations over a period of more than two decades. For US MNCs such as Ford and Procter & Gamble it has involved nurturing the ability to tap their foreign subsidiaries for technology, design, and new product ideas. For Japanese MNCs such as Nomura, Hitachi, and NEC the challenge is to become true insiders in the overseas countries where they do business.

Reconfiguring the MNC: The Transnational Corporation

Changing Organization Structure For North American and European-based MNCs, the principal structural changes of recent decades have been a shift from organization around national subsidiaries and regional groupings to the creation of worldwide product divisions. For most MNCs, country and regional organizations are retained, but primarily for the purposes of national compliance and customer relationships. Thus, Hewlett Packard conducts its business through global product groups: Technology Solutions Group (comprising Enterprise Storage and Servers, Services, and Software), Personal Systems Group (its personal computer and entertainment business), and Imaging and Printing Group (printers and cameras). At the same time, it maintains three regional headquarters: for the Americas (located in Houston), for Europe, Middle East and Africa (located in Geneva), and for Asia Pacific (located in Singapore).

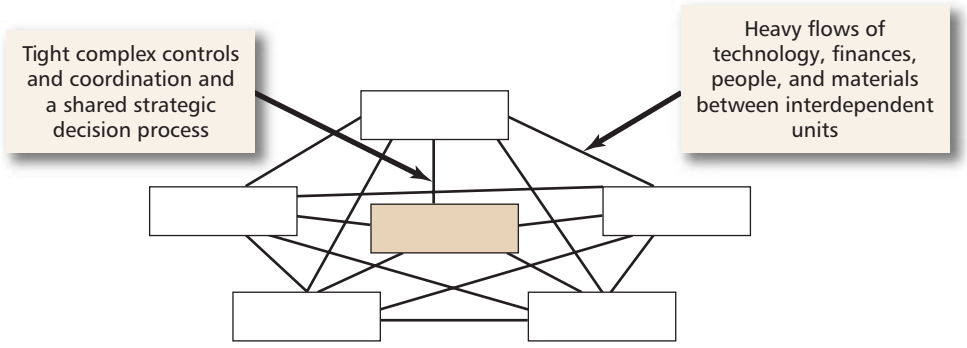
New Approaches to Reconciling Localization and Global Integration

However, the formal changes in structure are less important than the changes in responsibilities, decision powers, and modes of coordination within these structures. The fundamental challenge for MNCs has been reconciling the advantages of global integration with those of national differentiation. Escalating costs of research and new product development have made global strategies with global product platforms essential. At the same time, meeting consumer needs in each national market and responding swiftly to changing local circumstances requires greater decentralization. Accelerating technological change further exacerbates these contradictory forces: despite the cost and "critical mass" benefits of centralizing research and new product development, innovation occurs at multiple locations within the MNC and requires nurturing of creativity and initiative throughout the organization. "It's the corporate equivalent of being able to walk, chew gum, and whistle at the same time,' notes Harvard's Chris Bartlett.

According to Bartlett, the simultaneous pursuit of responsiveness to national markets and global coordination requires, "a very different kind of internal management process than existed in the relatively simple multinational or global organizations. This is the *transnational organization*."[38] The distinguishing characteristic of the transnational is that it becomes an integrated network of distributed and interdependent resource and capabilities (see Figure 14.9). This necessitates that:

- Each national unit is a source of ideas, skills, and capabilities that can be harnessed for the benefit of the total organization.
- National units access global scale economies by designating them the company's world source for a particular product, component, or activity.
- The center must establish a new, highly complex managing role that coordinates relationships among units but does so in a highly flexible way. The key is to focus less on managing activities directly and more on creating an organizational context that is conducive to the coordination and resolution of differences. Creating the right organizational context involves "establishing clear corporate objectives, developing managers with broadly based perspectives and relationships, and fostering supportive organizational norms and values."[39]

FIGURE 14.9 The transnational corporation



Balancing global integration and national differentiation requires that a company adapts to the differential requirements of different products, different functions, and different countries. Procter & Gamble adopts global standardization for some of its products (Pringles potato chips and high-end perfumes, for example); for others (hair coloring products and laundry detergent, for example) it allows significant national differentiation. Across countries, P&G organizes global product divisions to serve most of the industrialized world because of the similarities between their markets, while for emerging market countries (such as China and India) it operates through country subsidiaries in order to adapt to the distinctive features of these markets. Among functions, R&D is globally integrated while sales are organized by national units that are differentiated to meet local market characteristics.

The transnational form is a concept and direction of development rather than a distinct organizational archetype. It involves convergence of the different strategy configurations of MNCs. Thus, companies such as Philips, Unilever, and Siemens have reassigned roles and responsibilities to achieve greater integration within their traditional "decentralized federations" of national subsidiaries. Japanese global corporations such as Toyota and Matsushita have drastically reduced the roles of their Japanese headquarters. American multinationals such as Citigroup and IBM are moving in two directions: reducing the role of their US bases while increasing integration among their different national subsidiaries.

MNCs are increasingly locating management control of their global product divisions outside their home countries. When Philips adopted a product division structure, it located responsibility for medical electronics in its US subsidiary and leadership in consumer electronics in Japan. Nexans, the world's biggest manufacturer of electric cables, has moved the head office of five of its 20 product divisions outside of France. For example, the head of ships' cables is based in South Korea – the world leader in shipbuilding.[40] Aligning structure, strategy, and national resources may even require shifting the corporate headquarters – HSBC moved from Hong Kong to London, Tetra Pak from Lund, Sweden to Lausanne, Switzerland.[41]

Organizing R&D and New Product Development Probably the greatest challenges facing the top managers of MNCs is organizing, fostering, and exploiting innovation and new product development. Innovation is stimulated by diversity and autonomy, while its exploitation and diffusion require critical mass and coordination. The traditional European decentralized model is conducive to initiative – but not to its global exploitation. Philips has an outstanding record of innovation in consumer electronics. In its TV business, its Canadian subsidiary developed its first color TV; its Australian subsidiary developed its first stereo sound TV, and its British subsidiary developed teletext TVs. However, lack of global integration has constrained its ability successfully to exploit its innovation on a global scale. During the 1980s and 1990s, Philips was on the losing side of a number of key standards battles: its V2000 VCR system lost out to Matsushita's VHS system and its digital audio tape lost out to other digital recording formats.

By assigning national subsidiaries global mandates it is possible for them take advantage of local resources and develop distinctive capabilities while exploiting globally the results of their initiatives.[42] For example, P&G, recognizing Japanese obsessiveness over cleanliness, assigned increasing responsibility to its Japanese subsidiary for developing household cleaning products. Its "Swiffer" dust-collecting

products were developed in Japan (using technology from Kao) then introduced into other markets. Where local units possess unique capabilities, they can be identified as *centers of excellence* as a means of assigning them specific responsibilities and signaling this leadership to the rest of the organization.[43]

Summary

Moving from a national to an international business environment represents a quantum leap in complexity. In an international environment, a firm's potential for competitive advantage is determined not just by its own resources and capabilities but also by the conditions of the national environment in which it operates, including input prices, exchange rates, and a host of other factors. The extent to which a firm is positioned in a single market or multiple national markets also influences its competitive position.

Our approach in this chapter is to simplify the complexities of international strategy by applying the same basic tools of strategy analysis that we developed in earlier chapters. For example, in analyzing international expansion, the critical issue in determining whether a firm should enter an overseas market is an analysis of the profit implications of such an entry. This requires an analysis of (a) the attractiveness of the overseas market using the familiar tools of industry analysis, and (b) the potential of the firm to establish competitive advantage in that overseas market, which requires consideration of whether the firm can transfer its resources and capabilities from its home base to that overseas market, and whether these resources and capabilities can yield a competitive advantage in the same way as they did at home.

However, establishing the potential for a firm to create value from internationalization is only a beginning. Subsequent analysis needs to design an international strategy: Do we enter an overseas market by exporting, licensing, or direct investment? If the latter, should we set up a wholly owned subsidiary or a joint venture? Once the strategy has been established, then a suitable organizational structure needs to be designed.

The fact that so many companies that have been outstandingly successful in their home market have failed so miserably in their overseas expansion demonstrates the complexity of international management. In some cases, the companies have failed to recognize that the resources and capabilities that underpinned their competitive advantages in their home market could not be readily transferred or replicated in overseas markets. In others, the problems were in designing the structures and systems that could effectively implement the international strategy.

As the lessons of success and failure from international business become recognized and distilled into better theories and analytical frameworks, so we advance our understanding of how to design and implement strategies for competing globally. We are at the stage where we recognize the issues and the key determinants of competitive advantage in an international environment. However, there is much that we do not fully understand. Designing strategies and organizational structures that can reconcile critical tradeoffs between global scale economies versus local differentiation, decentralized learning and innovation versus worldwide diffusion and replication, and localized flexibilities versus international standardization remain key challenges for senior managers.

Self-Study Questions

1 With reference to Figure 14.1, identify a "sheltered industry" (i.e. one that has been subject to little penetration either by imports or foreign direct investment). Explain why the industry has escaped internationalization. Explore whether there are opportunities for profitable internationalization within the industry and, if so, the strategy that would offer the best chance of success.

2 With reference to Table 14.1, what characteristics of national resources explain the different patterns of comparative advantage for the US and Japan?

3 According to Michael Porter's *Competitive Advantage of Nations*, some of the industries where British companies have an international advantage are: advertising, auction trading of antiques and artwork, distilled alcoholic beverages, hand tools, and chemical preparations for gardening and horticulture.

Some of the industries where US companies have an international competitive advantage are: photo film, aircraft and helicopters, computer hardware and software, oilfield services, management consulting, cinema films and TV programs, healthcare products and services, and financial services.

For either the UK or the US, use Porter's national diamond framework (Figure 14.3) to explain the observed pattern of international competitive advantage.

4 When Porsche decided to enter the SUV market with its luxury Cayenne model, it surprised the auto industry by locating its new assembly plant in Leipzig in eastern Germany. Many observers believed that Porsche should have located the plant either in central or eastern Europe where labor costs were very low, or (like Mercedes and BMW) in the US where it would be close to its major market. Using the criteria outlined in Figure 14.4, can you explain Porsche's decision?

5 British expatriates living in the US frequently ask friends and relatives visiting from the UK to bring with them bars of Cadbury's chocolate on the basis that the Cadbury's chocolate available in the US (manufactured under license by Hershey's) is inferior to "the real thing.' Should Cadbury-Schweppes PLC maintain its licensing agreement with Hershey or should it seek to supply the US market itself, either by export form the UK or by establishing manufacturing facilities in the US?

6 Has McDonald's got the balance right between global standardization and national differentiation (see Strategy Capsule 14.2)? Should it offer its franchisees in overseas countries greater initiative in introducing products that meet national preferences? Should it also allow greater flexibility for its overseas franchisees to adapt store layout, operating practices, and marketing? What aspects of the McDonald's system should McDonald's top management insist on keeping globally standardized?

Notes

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