Block

3

INTERNATIONAL BUSINESS STRATEGY AND STRUCTURE

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Our E-mail id: cwfeedback@icfaiuniversity.in

Centre for Distance and Online Education (CDOE)
The ICFAI Foundation for Higher Education
(Deemed-to-be-University Under Section 3 of UGC Act, 1956)
Donthanapally, Shankarapalli Road, Hyderabad- 501203

BLOCK 3: INTERNATIONAL BUSINESS STRATEGY AND STRUCTURE

The third block to the course on International Business gives an overview of international strategy, organization of international business, and entry strategies and strategic alliances. The block contains three units. The first unit discusses different strategies used by companies to compete internationally. The second unit deals with the organization of international business. The third unit discusses different entry strategies firms adopt to compete in the global marketplace and strategic alliances.

The first unit, *The Strategy of International Business* discusses strategies pursued by firms for competing in international markets. It goes into explain how firms increase their profitability by expanding globally. It then discusses the pressures faced by firms in global markets related to cost reductions and local responsiveness. The unit finally discusses how firms choose their strategies when competing internationally.

The second unit, *The Organization of International Business* defines organizational architecture and explains its various components. It goes into explain the different dimensions of organizational structure. It then discusses different types of control systems and incentives. It then defines processes and how processes are managed in international business. It also discusses how an organizational culture is created and maintained and how it influences performance of a multinational in international business. It also discusses the synthesis of organizational architecture and strategy. The unit finally discusses organizational change and the strategies and tactics for implementing organizational change.

The third unit, *Entry Strategy and Strategic Alliances* discusses basic decisions a firm takes before going for foreign expansion. It then goes into explaining the various modes of entering a foreign market. It then discusses how an entry mode is selected. It also discusses Greenfield strategy, advantages and disadvantages of acquisition and Greenfield ventures. The unit finally discusses strategic alliances, its advantages and disadvantages, and how to make the alliances work.

Unit 7

The Strategy of International Business

Structure

"*There will be hunters and hunted, winners and losers. What counts in global competition is the right strategy and success.*"

- Heinrich von Pierer (Former CEO of Siemens AG)

7.1 Introduction

The previous block gave an overview of the international monetary system. It also dealt with the foreign exchange markets. It finally discussed international economic integration and different institutions.

International business managers increase the performance of their firms by expanding into foreign markets. They also deal with competitive pressures for competing in the global marketplace. Firms pursue different strategies when competing internationally and increase their profitability.

This unit will discuss strategies pursued by firms for competing in international markets. It then goes into explaining how firms increase their profitability by expanding globally. It then discusses the pressures faced by firms in global markets related to cost reductions and local responsiveness. The unit finally discusses how firms choose their strategies when competing internationally.

7.2 Objectives

By the end of this unit, you should be able to:

- Explain the basic principles of strategy and the value creation activities of a firm.
- Describe how global expansion helps a firm increase its profitability.
- Discuss the pressures faced by firms while competing in the global marketplace.
- Outline the different strategies that firms choose in response to different pressures when competing internationally.

7.3 Strategy and the Firm

The strategy of a firm can be defined as "the actions that managers take to attain the goals of the firm." For most of the firms, the major goal is to maximize the firm's value for its owners, shareholders. The value of the firm can be maximized by pursuing strategies that increase the profitability of the firm and its rate of profit growth over time. Profitability is "the rate of return that the firm makes on its invested capital (ROIC)." ROIC is calculated by dividing the firm's net profits by total invested capital. Profit growth can be measured by the percentage increase in net profits over time. Higher profitability and profit growth help in maximizing the value of a firm and thus the returns acquired the owners and shareholders.

To maximize firm's profitability, managers pursue strategies that lower costs or add value to the firm's products, which enable the firm to increase prices. Managers can increase the profit growth rate by pursuing strategies to sell more products in existing markets or enter new markets.

7.3.1 Value Creation

By creating more value, firms can increase their profitability. The value created by a firm is measured by the difference between its cost of production and the value perceived by the consumers in its products. However, the price charged by a firm for a good or a service is less than the value placed by the consumer. This is because consumers capture some of that value in the form of consumer surplus. The consumer is able to do this because the firm competes with other firms for the customer's business, so the firm has to charge a lower price than it could have it was the only supplier.

The strategy that focuses on lowering production costs is called as a low-cost strategy. The strategy that focuses chiefly on increasing the product attractiveness is called as a differentiation strategy. Michael Porter argues that low cost and differentiation are two strategies that create value and attain competitive advantage in an industry. According to Porter, firms that create superior value get superior profitability. Superior value could be created by driving down the cost structure of the business and/or differentiate their product so that the consumers value it more and are ready to pay a premium.

7.3.2 Strategic Positioning

According to Porter, a firm has to be explicit about its choice of strategic emphasis with regard to value creation and low cost. A firm should also be clear about configuring its internal operations for supporting that strategic emphasis.

Porter emphasizes that it is crucial for management to decide where the firm wants to be positioned with regard to cost and value, accordingly configure its operations, and manage them efficiently.

7.3.4 Operations

The firm's operations can be thought of a value chain consisting of distinct value creation activities including production, marketing and sales, materials management, research and development, human resources, information systems, and the firm infrastructure. The operations or value creation activities can categorized as primary activities and support activities. For a firm to implement its strategies efficiently, it should manage these strategies effectively.

7.3.5 Value Chain

A value chain is the "way in which primary and support activities are combined in providing goods and services and in increasing profit margins."

Primary Activities

Primary activities deal with the design, creation, delivery, marketing, support, and after-sales service of a product. The primary activities are divided into four functions such as research and development, production, marketing and sales, and customer service.

Research and Development (R&D) is concerned with the product design and the production process. R&D increases the product's functionality through superior design making it attractive for the customers to buy the product. In addition, R&D also results in more efficient production process, thereby cutting the costs of production. Either way, R&D creates value.

Production concerns creation of a good or service. For physical products, production means manufacturing. For instance, the production of an automobile. For services such as healthcare or banking, production occurs when the service is delivered to the customers. The production activity of a firm creates value by carrying out its activities efficiently so that it results in lower costs or a product of high-quality is produced.

The marketing and sales functions create value in several ways. Marketing through brand positioning and advertising, increases the value the customers perceive to be contained in the product. If these create favorable impression in the minds of the consumers, the firm can charge a premium.

The marketing and sales function also creates value by discovering the needs of the consumers and communicating them back to the R&D function, which can then design products suiting to the needs of the consumers.

The role of the service activity is to offer after-sales service and support. By offering support and solving problems of consumers, this function creates a perception of superior value in the consumers' minds.

Support Activities

The support activities of the value chain provide inputs for the primary activities to take place. For a firm to attain competitive advantage, the support activities are as important as the primary activities. The transmission of physical materials through the value chain, from procurement through production to distribution is controlled by the logistics function. The efficiency with which these functions are carried out can significantly lower costs, thereby creating more value.

The Human Resource (HR) function creates value by ensuring that the firm has the right mix of people to perform its value creation activities efficiently. The HR also ensures that the people are adequately trained, motivated, and compensated to carry out the value creation activities efficiently.

Information systems are electronic systems that track sales, manage inventory, price and sell products, deal with customer service queries, etc. Information systems coupled with the communication features of the Internet can help in altering the efficiency and effectiveness with which the firm manages its value chain activities.

Firm infrastructure is the final support activity. The infrastructure includes the control systems, organizational structure, and culture of the firm. As the top management exerts significant influence in shaping these aspects of a firm, it is also viewed as part of the firm's infrastructure. The top management shapes the firm's infrastructure through strong leadership thus resulting in enhancing the performance of all the value chain activities.

Example

Amazon India[1] announced in July 2021 that it would be expanding its storage capacity by more than 43 million cubic feet across 15 states to support its 8.5 lakh sellers across the country. These facilities would mean that there would be 11 new fulfillment centers and expansion of 9 existing ones across Maharashtra, Bihar, Gujarat, Assam, Rajasthan, among others. During the period 2020-21, Amazon increased its storage capacity by 40% in India. Here, infrastructure development is the support activity of the value chain that has been strengthened by Amazon India to provide value to its customers.

Source: ICFAI Research Center

7.4 Global Expansion and Profitability

Global expansion helps firms increase their profitability and profit growth rate. Firms operating internationally can:

- Expand the market for their local products by selling them in international markets.
- Realize location economies by dispersing individual value creation activities to those locations across the globe where they can be carried out effectively and efficiently.

[1] https://www.livemint.com/industry/retail/amazon-india-launches-11-new-fulfilment-centres-ahead-of-flagship-sale-11626346759811.html

- Realize greater cost economies by serving the global market from a central location thus reducing the value chain costs.
- By leveraging valuable skills developed in foreign operations, firms can earn greater return by transferring them to other entities within the global network of operations of the firm.

Market expansion: Leveraging products and competencies

A firm can increase its growth rate by taking goods or services developed domestically and selling them internationally. For instance, automobile companies such as Toyota and Volkswagen grew developing products at home and later sold them worldwide. The returns from such as strategy can be significant if the competitor in nations where a country enters lacks comparable products.

The success of multinational companies that expand in this manner not only depends on the good or services offered by them in the international markets but also on the core competencies that underlie the production, development, and marketing of those goods or services. Core competencies refers to "skills within the firm that competitors cannot easily match or imitate." These skills will be present in any of the value creation activities of the firm – production, marketing, R&D, human resources, logistics general management, etc. Such skills are expressed in product offerings that other firms cannot imitate or find it difficult to imitate. Core competencies form the basis for the firm's competitive advantage. They allow a firm to reduce the value creation costs and/or create a value so that products can be priced at a premium. For instance, Proctor & Gamble has a core competency in developing and marketing name brand consumer products.

Example

Nike had a visual logo that transcended language. Concentrating on using the logo rather than the name, Nike began by endorsing international athletes like Romanian tennis player Ilie Nastase, acclimatizing foreign populations to the Nike logo. The company used these athlete endorsements as the primary marketing tool for global expansion. Nike broadened the company vision from running shoes and began to brand athletic wear with the Nike name. Choosing to endorse cricket, soccer, golf, and other smaller sports strengthened the brand, equated it with sports success, and ultimately provided name recognition in every sports venue around the world.

Nike used the logo & athlete endorsements (cricket, soccer, golf, and other smaller sports strengthened the brand) as the primary marketing tool for global expansion that equated it with sports success, and provided name recognition in every sports venue around the world.

Source: ICFAI Research Center

Exhibit 7.1: Innovation as a Core Competency at Whirlpool

Whirlpool Corporation (Whirlpool) has always focused on having quality and cost reduction as its core competency. Whirlpool believed that only innovative products could command premium prices and build customer loyalty. The company emphasizes the need to develop an innovative culture that would spur Whirlpool's growth through consumer-focused innovation. This would be a part of the company's competitive strategy.

The practical aspect of such an initiative was also overwhelming. Whirlpool had to first figure out what it meant by innovation, how to measure success or failure, and how to inculcate creativity in its people.

Initially, Whirlpool had trouble deciding on its definition of innovation. The top management decided that any idea had to meet three criteria to be innovative it had to create a competitive advantage, it had to be unique and differentiating, and it had to create shareholder value. However, after working for about three years on those metrics, the management realized that these criteria alone would not be sufficient. Measuring the results was equally difficult. Linking the results of an innovation to revenues was another problem. The management at Whirlpool also had to consider: What should be the measure of success or failure: the number of employees trained in innovation or the revenue generated from innovation? What should be the goal for revenue generated from innovation in a year: should it be US$500 million, or should it be US$1 billion?

There was also the aspect of training the employees in creativity, giving them access to expertise and small amounts of seed funding, the freedom to work on their ideas, and a way to share information. In short, Whirlpool needed to set up a formal framework to bring about a culture change and supporting infrastructure like IT to support this change initiative. Another challenging aspect was that everything had to be built up from scratch.

While the core groups were being trained, the Vice President of leadership and strategic competency development at Whirlpool, focused on getting the rest of the Company's global workforce involved in the initiative through the Internet and innovation fairs. Strategos, a US-baed management consultancy firm, helped Whirlpool to put the necessary infrastructure in place and to use Information Technology (IT) to facilitate the objective. Whirlpool re-engineered management processes that slowed down innovation and used IT to improve and accelerate the innovation chain from idea to final product. Instead of going in for a few big projects, it encouraged many low-cost "stratlets" (also known as small strategies).

A leadership team was put in place. The team included a global director of KM, three regional vice presidents of innovation, and regional innovation boards (I-Boards) to set goals, allocate resources, and review ideas for funding.

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Executive I-boards in each region strove to keep the company's innovation pipeline full. They were responsible for building innovation capability, identifying the next generation of innovation consultants (I-consultants), coordinating innovation-related programs, and keeping innovation at the top of Whirlpool's corporate agenda. I- consultants were full-time staff that helped divisions adopt and implement innovation techniques. The I-consultants also facilitated individuals, groups, or business units to come up with new ideas and put these ideas into action.

Later, each major business unit also established an I-Board. Twenty-five people from each region were trained to serve as in-house I-consultants and I-mentors. The I-mentors were people specially trained to facilitate innovation projects and help people with their ideas. I-consultants hired their own team of I-mentors.

A knowledge management system called the Innovation E-Space was started which provided a course in innovation. It started with the "fuzzy front end" of innovation where random insights were systematically generated and shared to spark ideas. If an employee had a concept, he could go to the knowledge management system and post the idea on a bulletin board. The home page linked employees to all the tools and resources they needed, from insight libraries and innovation templates to I-mentors. According to Snyder, this provided an informal social system enabled by technology that worked across the hierarchy level.

All the projects that were in the pipeline were listed on the I-Pipe on the website. The I-Pipe gave a dashboard view of the innovation pipeline adapted from Strategos. It tracked ideas from concept to scale-up and provided project details as well as the big picture, enabling management to focus on areas that needed attention.

According to Hamel, the I-Pipe helped innovators to create strategy and top managers to edit it so as to fit the company's requirements. He also acknowledged that using IT to support innovation sessions was challenging.

The Innovation E-Space was cost-effective and did not require a big investment. On the front end, Whirlpool used a Lotus Notes-based intranet and added new capabilities using collaboration tools like QuickPlace and Sametime from Lotus. For the I-Pipe, the company built a platform on its SAP infrastructure using SAP's xApps for project resource management. Organizing tactical training was complemented by a significant amount of e-learning technology. Some courses were put online using LearningSpace of IBM Mindspan Solutions. Using such self-paced courses freed up Whirlpool resources for assignment on other products and significantly reduced costs.

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Whirlpool also hosted innovation fairs to felicitate inventors and encourage the flow of ideas. At these fairs, proud employees demonstrated their new designs and discussed their proposals.

Instead of waiting for employees to come out with ideas, the I-mentors helped employees reflect on customer needs, industry trends, and their own experience to come up with insights in formal innovation sessions.

The insight gained from the cross-fertilization of ideas between people from various disciplines such as marketing and engineering also helped. For the employees, the thrill of achievement was its own reward, and innovators received no bonuses or perks for their ideas.

Though initially Whirlpool got very few ideas out of the process, the rank-and-file employees were happy that their participation was being sought in important matters. However, the immediate superiors of the people who were engaged in this process and senior managers were not so happy as they thought that this initiative was a distraction from their regular work. Moreover, in the absence of concrete goals and this initiative not being tied to their performance in any way, the middle level management had little incentive to support the initiative. The hardest part for Whirlpool was to change the way leaders saw their roles as this required a huge shift in thinking. According to Snyder, only leaders could change an environment and allow an innovator the freedom to pursue different things.

Compiled from various sources.

7.4.1 Location Economies

Countries differ in different dimensions including economic, political, legal, and cultural and these differences can either lower or raise the costs of doing business in a country. According to the theory of international trade, certain countries have a comparative advantage in the production of certain factors due to factor cost differences. For instance, Japan excels in the production of automobiles and consumer electronics and the US excels in the field of biotechnology, pharmaceuticals, software, and financial services.

For a firm that tries to survive in a competitive global market implying that the trade barriers and transportation costs are permitted, the firm can benefit by basing its value creation activities at the location where political, cultural, and economic conditions including relative factor costs are conducive to the performance of that activity.

Firms pursuing such strategies realize location economies which can be defined as "the economies that arise from performing a value creation activity in the optimal location of that activity, wherever in the world that might be." Locating a value creation activity in the optimal location can have one of two effects. It can lower value creation costs and help the firm to achieve a low-cost position and/or enable a firm to differentiate its products from those of competitors.

7.4.2 Experience Effects

The experience curve refers "to systematic reductions in production costs that have been observed to occur over the life of a product." Some studies have observed that production costs decline by some quantity each time the cumulative output doubles. This was observed in the aircraft industry where each time the cumulative output of airframes doubled, the unit costs declined by 80 percent of their previous level.

Learning Effects

Learning effects are savings in cost that come from learning by doing. For instance, labor learns more efficiently by repeating how to carry out a task, such as assembling airframes. The labor productivity enhances over time as the laborers learn to perform the tasks more efficiently. Similarly, in production facilities management learns to manage new operations efficiently over time. Thus the increasing efficiency and management and labor productivity results in decline in production costs, which in turn enhances the profitability of the firm.

Learning effects become more significant when technologically complex tasks are repeated, because there is more to be learned about the task. Thus learning effects are noteworthy in an assembly process involving 1,000 complex steps than in just 100 simple steps. However, the learning effects are important only during the start-up period and disappear after two to three years. Any decline in the experience curve after such as point is attributed to economies of scale.

Example

AXA[2], the largest insurance company in the world, globalized by growing an impressive network of international subsidiaries. AXA's global expansion was also through the acquisition of local players. The company succeeded worldwide by taking its best practices and replicating them in each of those new organizations. For instance, AXA digitalized claim management and introduced the practice of 'payment within five days', across all AXA offices worldwide. Learning effect is the factor that has contributed to AXA's success in globalization.

When an organization operates on a large scale, it can acquire capabilities by mastering skills and learning best practices that in turn leads to improvement in performance. A global organization is successful if it can transfer this learning to all the new organizations it sets up worldwide as it expands globally. AXA's success can be attributed to learning and replication of the same in all AXA offices worldwide.

Source: ICFAI Research Center

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[2] https://analyticsindiamag.com/axa-business-services-utilizing-bangalore-centre-step-data-science-innovation/

Economies of Scale

Economies of scale refer to "the reductions in unit costs achieved by producing a large volume of a product." Attaining economies of scale helps in lowering unit costs of a firm and increases its profitability. There are number of sources of economies of scale. First, the ability of spreading fixed costs over a large volume. Fixed costs are costs incurred in a setting up production facility, developing a new product, etc. Second, a firm may not be able to attain efficient scale of production unless it serves the global markets.

Finally, as global sales increase the firm's size, its bargaining power increases, which may allow it to attain economies of scale in barraging down the cost of inputs, purchasing, and boosting profitability.

7.4.3 Leveraging Subsidiary Skills

Valuable skills are developed by a firm in its home market and are then transferred to foreign operations. For instance, Walmart developed its retailing skills in the US and then transferred them to its foreign operations. However, for mature multinationals that already has a network of subsidiary operations in foreign markets, valuable skills can be developed in foreign subsidiaries as well.

Leveraging the skills developed within subsidiaries and applied to the firm's other operations under the firm's global network may create value.

This phenomenon creates new challenges for managers of multinational enterprises. First, they should have the humility to recognize that valuable skills that lead to competencies can arise anywhere within the global network of the firm and not just at the corporate center. Second, they should establish an incentive system that encourages local employees to acquire new skills. Third, managers should have a process to identify when valuable skills have been created in a subsidiary. Finally, managers have to act as facilitators for transferring the valuable skills within the firm.

Activity 7.1

EyeVision, a manufacturer and distributor of eyewear, has its production facilities in three continents around the world. In the 1980s, the strong dollar made the US-based eye manufacturing very expensive. Low-priced imports were capturing a larger share of the US eyewear market. Thus EyeVision realized that for its survival it needed to import its product. Initially the firm bought from overseas manufacturer in Hong Kong. But recently, EyeVision has set up its own facility in Hong Kong due to low cost labor, skilled workforce and tax breaks offered by the Hong Kong government. Identify the strategy adopted by EyeVision for carrying out its overseas operations and discuss the advantages reaped by EyeVison while pursuing this strategy. Also discuss other strategies that help firms increase their profitability while competing in global markets.

Answer:

7.5 Pressures for Cost and Local Responsiveness

Firms competing in a global marketplace face two types of competitive pressures that have an effect on their ability to realize location economies and experience effects, for leveraging products and transferring competencies and skills within the firm. They face pressures for cost reduction and pressures for local responsiveness. These pressures place competitive demands on a firm. For responding to cost pressures, a firm has to minimize its unit costs. For responding to pressures of local responsiveness, a firm has to differentiate its marketing strategy and product offering from one country to another in a bid to accommodate diverse set of demands that arise due to national differences in consumer tastes and preferences, distribution channels, business practices, competitive conditions, and government policies. As differentiation across countries may involve significant duplication and a lack of standardization of products, it may increase costs.

7.5.1 Cost Reduction Pressures

International business often faces cost pressures in competitive global markets. For responding to cost pressures, a firm has to lower its value creation costs. For instance, a manufacture may mass-produce a product at an optimal location in the world and may outsource certain functions to low-cost suppliers in a bid to reduce costs.

Example

Apple[3], a US-based multinational technology company, specializes in consumer electronics. Apple targets only high-end customers. Apple has been able to keep costs relatively low by having standardized products, which is one of its globalization strategies requiring global coordination through its suppliers. Apple products are precisely standardized throughout international markets and suppliers across the world, which reduces costs and overhead. In Asia, Apple's sales will be under pressure due to the aggressive pricing of mobile phones by Asian manufacturers. Apple has lost market in certain countries because of its attempt to maintain profit margins or even improve them. Apple faces tremendous cost reduction pressure because of the aggressive pricing policy of its competitors.

Source: ICFAI Research Center

[3] https://www.cnbc.com/2019/01/03/costly-iphones-innovation-and-market-saturation-doomed-apple.html

Cost reduction pressures can be intense in industries where commodity-type products are produced where differentiation on non-price factors is difficult and price is the major competitive weapon. This is in case of products that serve universal needs. Universal needs exist when tastes and preferences of consumers in different nations are similar if not identical. For instance, conventional commodity products such as petroleum, sugar, steel, etc. It is also the case for several industrial and consumer products such as personal computers, liquid crystal display screens, handheld calculators, semiconductor chips, etc.

Cost reduction pressures are also intense in industries where major competitors are based in low-cost locations, where consumers are powerful and face low switching costs, and where there is persistent excess capacity. The liberalization of the world trade and investment environment by facilitating greater international competition has resulted in an increase in cost pressures.

7.5.2 Local Responsiveness Pressures

Local responsiveness pressures arise from national differences in consumer tastes and preferences, infrastructure, business practices, distribution channels, and from demand of the host-government. To respond to these pressures, a firm has to differentiate its products and marketing strategy across countries for accommodating these factors, all of which tend to raise the cost structure of the firm.

7.5.3 Differences in Consumer Tastes and Preferences

The consumer tastes and preferences differ significantly across countries due to deeply rooted historic or cultural reasons. In such cases, a multinational's marketing message should be customized to appeal to the local consumers. This creates pressures for a firm to delegate production and marketing functions and responsibilities to the overseas subsidiaries of a firm. For instance, consumers in North America have a strong demand for pickup truck whereas the European consumers consider pickup trucks as utility vehicles and are purchased majorly by firms as opposed to individuals.

Some commentators argue that consumer demands for localization are on a decline worldwide. This was highlighted by the fact that modern communication and transport technologies have created conditions for convergence of consumer tastes and preferences from different nations. This has resulted in emergence of several global markets with standardized consumer products. For instance, companies such as Coca-Cola, McDonalds. Nokia cell phones, Sony PlayStations have gained worldwide acceptance.

However, significant differences in consumer tastes and preferences still exist across nations and cultures. International business managers yet do not have the luxury to ignore such differences.

7.5.4 Differences in Infrastructure and Traditional Practices

The local responsiveness pressures that arise from differences in infrastructure and traditional practices create a need for product customization. This requires a firm to delegate its manufacturing and production functions to its foreign subsidiaries. For example, in North America, electrical systems are based on about 110 volts whereas in European countries, the standard is about 240 volts. Thus, domestic electrical appliances are required to be customized for this difference in infrastructure. The traditional practices also differ among nations. For instance, people in Britain drive left-hand cars thus creating a demand for right-hand cars whereas in France, people drive right-hand drive cars and hence want left-hand drive cars.

Example

A Technical Standard known as GSM (Global System for Mobile communications) is common in countries like Europe. The alternative standard CDMA (Code Division Multiple Access) is more common in the USA and parts of Asia. Equipment designed for GSM doesn't work for CDMA. Thus domestic switches are required to customize for this difference in infrastructure. As such, companies like Nokia, Motorola and Ericsson manufactures switches in the respective countries in accordance with the technical standard prevailing in the given country. Nokia, Motorola and Ericsson got into manufacturing of switches to bring compatibility between GSM and CDMA that could customize their product according to the technical standard prevailing in a given country.

Source: ICFAI Research Center

7.5.5 Differences in Distribution Channels

The marketing strategies of a firm have to be responsive to differences in distribution channels among countries, which may demand delegation of the marketing functions to national subsidiaries. For instance, in the pharmaceutical industry, the Japanese and the British systems are radically different from the US system. Japanese and British doctors do not respond to a high-pressure sales force. Thus, pharmaceutical companies have to adopt different marketing practices in Japan and Britain compared with the US.

Example

Amazon moves to direct marketing whenever possible. For years, Amazon sold its products through the intermediary of various postal / courier services. Therefore, the company had little control over the time of delivery or the look of the product delivered. To ensure faster delivery, Amazon developed alternative channels that are more direct. For example, in some cities, Amazon customers can pick up items left in lockers by Amazon employees.

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Amazon couriers also deliver products in many major cities. By eliminating intermediaries where possible, Amazon was able to exert more control over delivery times and address customer concerns. With Speed and customer satisfaction being important to Amazon, the company invested in delivery intermediaries that optimized the delivery speed and quality that aligned with its business priorities and mission.

Amazon eliminated distribution intermediaries and developed alternative channels which are more direct thus meeting its business priorities and mission of Speed and Customer satisfaction.

Source: ICFAI Research Center

7.5.6 Host-government Demands

Political and economic demands imposed by governments of the host country may require local responsiveness. For example, pharmaceutical companies are subject to registration procedures, local clinical testing, and pricing restrictions, all of which make it essential that the manufacturing and marketing of a drug should meet local requirements. As governments and government agencies control a significant proportion of the healthcare budget in most of the countries, they are in a powerful position to demand a high-level of local responsiveness.

In general, threats of protectionism, local content rules, and economic nationalism dictate that international businesses manufacture locally. For example, Canada-based manufacturer of railcars, jet boats, and aircraft has 12 railcar factories in Europe. Critics argue that resulting duplication of manufacturing facilities leads to high costs and helps explain why Bombardier makes lower profit margins on its railcar operations than on its other line of businesses. In reply, Bombardier managers argue that in Europe, informal rules with regard to local content favor people using local workers. For selling railcars in Germany, they claim manufacturing should be done in Germany. For addressing its cost structure in Europe, bombardier has centralized its engineering and purchasing functions but has no plans for centralizing manufacturing.

Example

Bombardier is the Canadian-based manufacturer of railcars, aircraft, jet boats, and snowmobiles. Bombardier has 12 railcar factories across Europe. The duplication of manufacturing facilities led to high costs and lower profit margins on its railcar operations than on its other business lines. However, to sell railcars in Germany, the local rule mandates the product to be manufactured in Germany. The same goes for Belgium, Austria, and France. Hence, to address its cost structure in Europe, Bombardier has centralized its engineering and purchasing functions, but didn't centralize manufacturing.

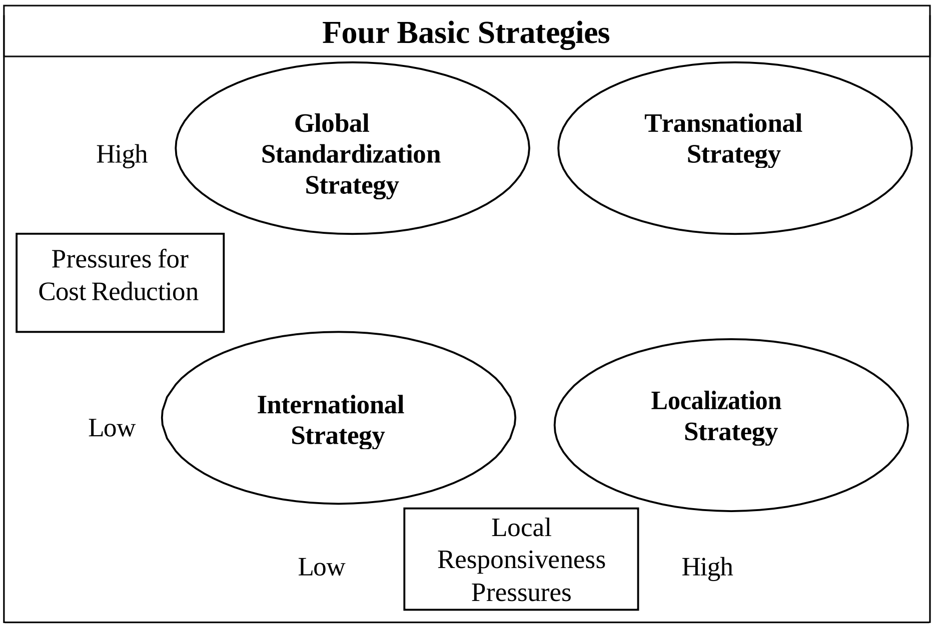
Bombardier didn’t centralize the manufacturing, but had manufacturing units in respective countries to align with the local rules on selling.

Source: ICFAI Research Center

7.6 Choosing a Strategy

When competing internationally, firms typically select from one of the four strategies – global standardization strategy, localization strategy, transnational strategy, and international strategy. The appropriateness of each strategy varies given the extent of cost reduction and local responsiveness pressures. Figure 7.1 illustrates the conditions under which each of these strategies is most appropriate.

Figure 7.1



Adapted from Charles W Hill and Arjun K Jain, International Business: Competing in the Global Marketplace, Mc-Graw-Hill Companies, Sixth edition.

7.6.1 Global Standardization Strategy

Firms pursuing a global standardization strategy focus on increasing profitability and profit growth by reaping reductions in cost arising from location economies, learning effects, and economies of scale, that is, the strategic goal of a firm is to pursue a low-cost strategy on a global scale. The marketing, R&D, and production activities of a firm that pursues a global standardization strategy are concentrated in some favorable locations. Such firms do not make any attempt to customize their product offering and marketing strategy to local conditions as customization involves shorter production runs and the duplication of functions, which may increase costs. Instead, firms prefer to market a standardized product worldwide for reaping maximum benefits from learning effects and economies of scale. They may also make use of their cost advantage for supporting aggressive pricing in world markets.

The global standardization strategy makes lot of sense when the demand for local responsiveness is minimal and there are strong pressures for cost reductions.

These conditions are prevalent in many industrial goods industries whose products serve universal needs. For instance, in the semiconductor industry, global standards have emerged, creating huge demand for standardized global products. Accordingly, companies such as Texas Instruments, Intel, and Motorola pursue a global standardization strategy. However, these conditions are not found in consumer goods markets, where demand for local responsiveness is high.

Example

Coca-Cola Company keeps the appearance of the product relatively unchanged between different markets. The company uses the same design theme even when different languages are presented on the products. Coca-Cola's marketing also maintains a consistent theme to help reinforce the image it is presenting. Coca-Cola standardized its theme across the globe.

Source: ICFAI Research Center

7.6.2 Localization Strategy

A localization strategy focuses on increasing the profitability of a firm by customizing its goods or services so that they offer a good match to tastes and preferences in different national markets. Localization can be appropriate when cost pressures are not too intense and when there are substantial differences across nations regarding consumer tastes and preferences. By customizing a product to suit to the local demands, a firm increases the product value in the local market. However, as customization involves duplication of functions and smaller production runs, it limits the ability of a firm to capture the cost reductions that are associated with mass-producing of a standardized product for global consumption. MTV is a good example of a company that has adopted localization strategy. If it had not localized its programs, it would have lost its market share to local competitors; its advertising revenues would have fallen, and its profitability would have declined.

Example

Domino’s Pizza regularly update their menu and topping choices to incorporate local tastes and food preferences. By including options like paneer pizza, chicken tikka masala pizza and kheema do pyaza pizza on the menu, Domino’s is all set to make India its largest market outside the US.

Source: ICFAI Research Center

7.6.3 Transnational Strategy

When a firm simultaneously faces strong cost pressures and pressures for local responsiveness, it is advisable for them to pursue a transnational strategy.

According to researchers Christopher Bartlett and Sumantra Ghoshal, in today’s global environment, competitive pressures are so intense that to survive, firms need to do anything to respond to pressures for cost reductions and local responsiveness. Firms should realize experience effects and location economies for leveraging products internationally, for transferring core competencies and skills within the company, and for paying attention to local responsiveness pressures. Bartlett and Ghoshal note that in modern multinational enterprise, core competencies and skills do not reside just in the home country but can also be developed in any of the firm's operations worldwide. Thus, they maintain that flow of product offerings and skills should not just flow from home country to foreign subsidiary but also from foreign subsidiary to home country and foreign subsidiary to foreign subsidiary. In other words, transnational enterprises should focus on leveraging skills of the subsidiary.

In essence, firms pursuing a transnational strategy make attempts to simultaneously achieve low costs from location economies, learning effects, and economies of scale; differentiate their product offerings across geographic markets for accounting local differences; and fostering a multidirectional flow of skills between different subsidiaries of the firm. The transnational strategy is not easy to pursue as it places conflicting demands on the company. Differentiating the product in different geographic markets to suit to the local demands may increase costs, which is in contrast to the firm's goal of reducing costs.

Example

India does not have Apple owned and managed Stores. rather, it has many authorised and exclusive Apple products sellers like iStore, Nyasa, Maple etc. Apple has mandated all these stores to have their store layout and interior design in sync with the Apple Stores. The kind of furniture used, or the way the products are displayed are all controlled by the head office. This not only limited Apple to make a onetime investment and routine maintenance, avoided recurring costs of running own stores, but also enabled Apple to give the same look and feel to its customers all over the world without compromising on the simplistic sophistication that its stores display.

Source: ICFAI Research Center

7.6.4 International Strategy

Some multinationals find themselves in fortunate positions where they confront low cost pressures and low pressures for local responsiveness. Such firms pursue an international strategy where products are produced in the domestic market and are then sold in international markets with minimal localization. The distinguishing feature of such firms is that they sell products that serve universal needs but do not face significant competitors and thus unlike firms pursuing a global standardization strategy are not confronted with pressures for reducing their cost structures.

Firms pursuing an international strategy have followed a similar developmental pattern as they expanded in foreign markets. They tend to centralize product development functions such as R&D at home. However, they may also make attempts to establish manufacturing and marketing functions in each major geographic region or country where they conduct their business. The resulting duplication can increase costs, but this is not a major issue if a firm does not face strong pressures for cost reductions. Though the firms may undertake some local customization of marketing strategy and product offering, this may be limited in scope. Eventually, in most of the firms that pursue an international strategy, the head office retains tight control over product and marketing strategy.

Example

US-based food and beverage producer PepsiCo is split into three major divisions: PepsiCo Americas Beverages (PAB), PepsiCo Americas Foods (PAF) and PepsiCo International (PI). For most of its soft drink brands, PAB manufactures and sells concentrate to licensed bottlers, who sell the branded products to independent distributors and retailers, while providing marketing, promotional and sales support. Similarly PepsiCo's Lay's potato chips are marketed across the globe as a healthful snack product because of reduced saturated fat content. PepsiCo continues to develop products or variants of existing ones, such as low-calorie, reduced-salt, or low-saturated-fat variants of its food and beverage products. PepsiCo continues to expand its distribution network to reach the last remaining markets or segments, especially in developing regions which in turn supports the growth of its distribution network. Thus the three methods that enables PepsiCo to minimize the costs despite additional investments used for expansion to new markets or market segments are - a) localized sales opportunities, b) shoring up and strengthening its North American businesses, and c) speeding up international expansion. Further, PepsiCo's organizational structure features a hierarchy that spans the global organization and typically supports monitoring, control and governance at the global/corporate level.

Source: ICFAI Research Center

Activity 7.2

MCS Corporation (MCS), a software company based in Redmond USA carried bulk of its product development at its headquarters in Redmond. Some of the work such as producing foreign-language versions of popular software programs was localized elsewhere. The company sold its products in majority of the international markets. Identify the strategy pursued by MCS. Also discuss other strategies pursued by firms when competing internationally.

Answer:

Check Your Progress - 1

1. __________is the rate of return that the firm makes on its invested capital (ROIC).
   a. Profitability
   b. ROIC
   c. Profit growth
   d. Value chain
2. The strategy that focuses on lowering production costs is called as a __.
   a. High-cost strategy
   b. Profitability strategy
   c. Low-cost strategy
   d. Differentiation strategy
3. The strategy that focuses chiefly on increasing the product attractiveness is called as a _.
   a. Differentiation strategy
   b. High-cost strategy
   c. Profit growth
   d. Low-cost strategy
4. __________argues that low cost and differentiation are two strategies that create value and attain competitive advantage in an industry.
   a. Sumanta Ghoshal
   b. Christopher Bartlett
   c. Michael Porter
   d. None of the above
5. The ______ activities of the value chain are divided into four functions such as research and development, production, marketing and sales, and customer service.
   a. Secondary
   b. Primary
   c. Support
   d. Chief
6. The ______function creates value by ensuring that the firm has the right mix of people to perform its value creation activities efficiently.
   a. Logistics
   b. Human resource
   c. Production
   d. Marketing

7. __________are electronic systems that track sales, manage inventory, price and sell products, deal with customer service queries, etc.
   a. Materials management
   b. Information systems
   c. Operations management
   d. Brand management
8. The transmission of physical materials through the value chain, from procurement through production to distribution is controlled by the ___function.
   a. Operations research
   b. Advertising
   c. Profitability
   d. Logistics
9. __________is the final support activity.
   a. Production
   b. Firm infrastructure
   c. Human resource
   d. Logistics
10. __________refers to skills within the firm that competitors cannot easily match or imitate.
    a. Value creation
    b. Strategy
    c. Core competencies
    d. Logistics
11. __________can be defined as the economies that arise from performing a value creation activity in the optimal location of that activity, wherever in the world that might be.
    a. Location economies
    b. Strategic positioning
    c. Leveraging
    d. Value chain
12. The ______refers to systematic reductions in production costs that have been observed to occur over the life of a product.
    a. Profitability curve
    b. ROIC
    c. Experience curve
    d. Supply chain curve

13. __________refer to the reductions in unit costs achieved by producing a large volume of a product.
    a. Location economies
    b. Economies of scale
    c. Profit growth
    d. Learning effects
14. __________exist when tastes and preferences of consumers in different nations are similar if not identical.
    a. Profitability needs
    b. Local needs
    c. Universal needs
    d. Strategic needs
15. __________pressures arise from national differences in consumer tastes and preferences, infrastructure, business practices, distribution channels, and from demand of the host-government.
    a. Profitability
    b. Local responsiveness
    c. Cost
    d. Global
16. Firms pursuing a/an _______strategy focus on increasing profitability and profit growth by reaping reductions in cost arising from location economies, learning effects, and economies of scale.
    a. Global standardization
    b. International
    c. Profit
    d. Transnational
17. A/An _____strategy focuses on increasing the profitability of a firm by customizing its goods or services so that they offer a good match to tastes and preferences in different national markets.
    a. Transnational
    b. International
    c. Localization
    d. Global standardization
18. When a firm simultaneously faces strong cost pressures and pressures for local responsiveness, it is advisable for them to pursue a ____strategy.
    a. Profitability
    b. ROIC
    c. Profit growth
    d. Transnational

19. A/An _____strategy is pursued by firms when products are produced in the domestic market and are then sold in international markets with minimal localization.
    a. Profitability
    b. International
    c. Profit growth
    d. Value chain

7.7 Summary

- The strategy of a firm can be defined as the actions that managers take to attain the goals of the firm.
- The value created by a firm is measured by the difference between its cost of production and the value perceived by the consumers in its products.
- The operations or value creation activities can categorized as primary activities and support activities. For a firm to implement its strategies efficiently, it should manage these strategies effectively.
- Primary activities deal with the design, creation, delivery, marketing, support, and after-sales service of a product. The primary activities are divided into four functions such as research and development, production, marketing and sales, and customer service.
- The support activities of the value chain provide inputs for the primary activities to take place.
- Global expansion helps firms increase their profitability and profit growth rate. Firms operating internationally can expand the market for their local products by selling them in international markets, by realizing location economies, by realizing greater cost economies, and by leveraging valuable skills developed in foreign operations.
- Firms competing in a global marketplace face two types of competitive pressures – pressures for cost reduction and pressures for local responsiveness. These pressures have an effect on their ability to realize location economies and experience effects, for leveraging products and transferring competencies and skills within the firm.
- When competing internationally, firms typically select from one of the four strategies – global standardization strategy, localization strategy, transnational strategy, and international strategy.

7.8 Glossary

Core competencies: Core competencies refer to skills within the firm that competitors cannot easily match or imitate.

Differentiation strategy: The strategy that focuses chiefly on increasing the product attractiveness is called as a differentiation strategy.

Economies of scale: Economies of scale refer to the reductions in unit costs achieved by producing a large volume of a product.

Location economies: The economies that arise from performing a value creation activity in the optimal location of that activity, wherever in the world that might be are referred to as location economies.

Low-cost strategy: The strategy that focuses on lowering production costs is called as a low-cost strategy.

Profitability: Profitability is the rate of return that the firm makes on its invested capital (ROIC).

Strategy of a firm: The strategy of a firm can be defined as the actions that managers take to attain the goals of the firm.

7.9 Self-Assessment Test

1. Define a firm's strategy. Explain how profitability and profit growth can be measured.
2. Describe the value chain activities of a firm.
3. Explain how firms can expand their markets by leveraging on its products and core competencies.
4. Discuss how firms attain location economies.
5. Explain how firms realize greater cost economies from experience effects.
6. Describe how firms earn a greater return by leveraging valuable skills developed in their foreign operations.
7. Discuss the cost pressures and pressures for local responsiveness faced by firms while competing in the global marketplace.
8. When competing internationally, firms typically select from one of the four strategies – global standardization strategy, localization strategy, transnational strategy, and international strategy. Describe these strategies in detail.

7.10 Suggested Readings/Reference Material

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7.11 Answers to Check Your Progress Questions

1. (a) Profitability

Profitability is the rate of return that the firm makes on its invested capital (ROIC).

2. (c) Low-cost strategy

The strategy that focuses on lowering production costs is called as a low-cost strategy.

3. (a) Differentiation strategy

The strategy that focuses chiefly on increasing the product attractiveness is called as a differentiation strategy.

4. (c) Michael Porter

Michael Porter argues that low cost and differentiation are two strategies that create value and attain competitive advantage in an industry.

5. (b) Primary activities

The primary activities of the value chain are divided into four functions such as research and development, production, marketing and sales, and customer service.

6. (b) Human resource

The human resource (HR) function creates value by ensuring that the firm has the right mix of people to perform its value creation activities efficiently.

7. (b) Information systems

Information systems are electronic systems that track sales, manage inventory, price and sell products, deal with customer service queries, etc.

8. (d) Logistics

The transmission of physical materials through the value chain, from procurement through production to distribution is controlled by the logistics function.

9. (b) Firm infrastructure

Firm infrastructure is the final support activity.

10. (c) Core competencies

Core competencies refers to skills within the firm that competitors cannot easily match or imitate

11. (a) Location economies

Location economies can be defined as the economies that arise from performing a value creation activity in the optimal location of that activity, wherever in the world that might be.

12. (c) Experience curve

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

13. (b) Economies of scale

Economies of scale refer to the reductions in unit costs achieved by producing a large volume of a product.

14. (c) Universal needs

Universal needs exist when tastes and preferences of consumers in different nations are similar if not identical.

15. (b) Local responsiveness

Local responsiveness pressures arise from national differences in consumer tastes and preferences, infrastructure, business practices, distribution channels, and from demand of the host-government.

16. (a) Global standardization strategy

Firms pursuing a global standardization strategy focus on increasing profitability and profit growth by reaping reductions in cost arising from location economies, learning effects, and economies of scale.

17. (c) Localization strategy

A localization strategy focuses on increasing the profitability of a firm by customizing its goods or services so that they offer a good match to tastes and preferences in different national markets.

18. (d) Transnational strategy

When a firm simultaneously faces strong cost pressures and pressures for local responsiveness, it is advisable for them to pursue a transnational strategy.

19. (b) International strategy

A/An International strategy is pursued by firms when products are produced in the domestic market and are then sold in international markets with minimal localization.

Unit 8

The Organization of International Business

Structure

"Every company has two organizational structures: The formal one is written on the charts; the other is the everyday relationship of the men and women in the organization."

- Harold S. Geneen, American Businessman

8.1 Introduction

The previous unit discussed strategies pursued by firms for competing in international markets. It then explained how firms increase their profitability by expanding globally. It then discussed the pressures faced by firms in global markets related to cost reductions and local responsiveness. The unit finally discussed how firms choose their strategies when competing internationally.

International businesses use an organizational architecture to manage and direct their global operations. For a firm to ensure profitability, the elements of the organizational architecture should be consistent internally, the strategy must fit the organization architecture, and finally the strategy and architecture should not only be consistent with each other, but should also be consistent with the competitive conditions prevailing in the market.

This unit will define organizational architecture and explain its various components. It then goes into explaining the different dimensions of organizational structure. It then discusses different types of control systems and incentives. It then defines processes and how processes are managed in international business. It also discusses how an organizational culture is created and maintained and how it influences performance of a multinational in international business. It also discusses the synthesis of organizational architecture and strategy. The unit finally discusses organizational change and the strategies and tactics for implementing organizational change.

8.2 Objectives

By the end of this unit, you should be able to:

- Define organization architecture and explain its various components.
- Explain the different dimensions of organizational structure, control systems and incentives.
- Discuss how organizational culture is created and maintained and its influence in international business.
- Describe the synthesis of organization architecture and strategy.
- Outline the strategies and tactics for implementing organizational change.

8.3 Organizational Architecture

Organizational architecture refers to “the totality of a firm’s organization, including formal organizational structure, control systems and incentives, organizational culture, processes, and people.”

Organizational structure includes three things: first, the formal organization division into subunits such as product divisions, national operations, and functions. Second, the location of decision making responsibilities within that structure. Third, establishing integrating mechanisms for coordinating the activities of subunits including cross-functional teams and/or pan-regional committees.

Control systems are metrics that measure the performance of the subunits and make judgments about how well the managers are running those subunits. For instance, Unilever measured the performance of its national operating subsidiaries by setting profitability as the metric. Incentives are devices used for rewarding appropriate managerial behavior. For instance, a manager of a unit may receive a bonus if the performance targets are achieved.

Processes are the manner in which work is carried out and how decisions are made in an organization. Examples of processes include strategy formulation, resource allocation, etc.

Organizational culture refers to “the norms and value systems that are shared among the employees of an organization.” Organizations are composed of societies of individuals who come together to perform tasks collectively. They have their distinctive cultural and sub-cultural patterns. Finally, people not just refers to the employees in an organization, but also the strategy to recruit, compensate, and retain those employees and the kind of people they are in terms of values, skills, and orientation.

The various components of organization architecture are not independent of each other. Each component is shaped by another component. For a firm to maximize its profitability should pay attention to achieving internal consistency between the various components of the architecture. Some inconsistency exists in the design of the organization architecture. Though perfection cannot be achieved in the organization architecture design, it can be minimized through intelligent design.

Consistency between architecture and strategy is required because architecture must fit strategy. It is relatively easy for senior managers to announce a change in the strategy; but is harder to put into action. A change in strategy also requires a change in the architecture, and changing architecture is much more difficult than changing the strategy.

Even with an internal consistency and a fit between strategy and architecture, high performance cannot be guaranteed. The firm has to ensure that the fusion of strategy and architecture is consistent with the demands of the market in which the firm competes.

8.4 Organizational Structure

Organizational structure can be understood in terms of three dimensions – (1) vertical differentiation, which refers to the location of decision making responsibilities within a structure; (2) horizontal differentiation, which refers to the formal organizational division into subunits; and (3) establishing integrating mechanisms, which are mechanisms to coordinate the subunits.

8.4.1 Vertical Differentiation

Every Multinational enterprise faces the tough task of balancing global integration with local differentiation. This polarity can be expressed in terms of standardization versus customization, efficiency versus effectiveness, etc. The dilemma remains the same irrespective of the terms used. All organizations should address who has the authority to make what decisions. For instance, who should make factory decisions, where does the responsibility for development and promotion of products lie? In broad terms, determining in the organizational hierarchy the authority to make decisions stands is the issue of vertical differentiation. Vertical differentiation in a firm determines where the power and responsibility of decision making is concentrated in the organizational hierarchy. It gives an idea whether the decision making is centralized or decentralized. If the decision on important matters is taken by the company headquarters it is called as centralized decision making. If the decision is taken by local/foreign subsidiaries or by the lower level managers, then the decision is called as decentralized decision making. There are arguments for centralization and decentralization.

Example

Samsung Electronics corporate structure involves a hierarchical model, despite its product-type divisions. The corporate headquarters are the most notable manifestation of this hierarchy, which is part of an organizational design for ensuring that the conglomerate's operations are unified and effectively directed towards growth and operational effectiveness. Samsung has centralization of overall strategic planning at the corporate headquarters, as well as the lines of command and authority that relay strategic directions from the headquarters to the daily operations in the Consumer Electronics, Device Solutions, and IT & Mobile Communications divisions.

Source: ICFAI Research Center

8.4.2 Arguments for Centralization

There are four main arguments for centralization. First, it facilitates coordination. Second, it ensures that decisions are consistent with the organizational objectives. Third, it gives top-level managers means to bring about needed organizational changes by concentrating power and authority in one individual or a management team. Fourth, it avoids duplication of activities that occurs when similar activities are carried on by various subunits within the organization.

Example

Tesla, Inc. (formerly Tesla Motors, Inc.) as a manufacturer of electric automobiles, batteries, solar panels, and related transportation and energy solutions, uses its corporate structure to facilitate extensive control of the organization. Elon Musk's leadership from the Head Quarters disseminates and supports the implementation of new strategies for business growth and improvement. The company has a structural group of employees for engineering, and another for sales and service. These heads of the offices of the global hierarchy form the corporation's central headquarters, which directly control all operations. Thus Tesla minimally supports the autonomy of its regional or overseas offices as the company's headquarters make most of the decisions for overseas operations too.

Source: ICFAI Research Center

8.4.3 Arguments for Decentralization

There are five main arguments for decentralization. First, top management becomes overburdened when the decision making authority is centralized, and this can result in poor decisions. Decentralization gives time to top management to focus on critical issues by delegating routine tasks to lower-level managers.

Second, motivational research favors decentralization. Third, decentralization allows for flexibility. Fourth, Decentralization results in better decision making. Fifth, decentralization can increase control.

Example

Founded in 1912 in the United States of America, Illinois Tool Works (ITW) is an American Fortune 500 company that produces engineered fasteners and components, equipment and consumable systems, and specialty products. As of July 2018, ITW has $6 billion in sales, it has 400 units whose average revenue $15 million. Each unit has a General Manager (GM). The GM runs the division as if it were his/her own business. This continues till the unit outperforms everyone else in the specific market. Each GM undergoes 6 rounds of rigorous and in-depth interactions with one of the 7 Executive Vice Presidents that results in the setting-up of the unit's goals basing on the place it stands among the internal competition. When a unit starts to outperform — or underperform — the competition, it is split into more pieces, usually along tightly focused product lines. This resulted in ITW’s ten-year average annual earnings growth of 16% and five-year total return on capital of 19% exceeding that of capital goods heavyweight General Electric.

Source: ICFAI Research Center

8.4.4 Centralization and Strategy in International Business

It usually makes sense for firms to centralize some decisions and decentralize others, depending on the strategy of the firm and the type of decision. Decisions related to overall strategy of the firm, financial objectives, major financial expenditure, and legal issues are typically centralized at the headquarters of the firm. However, operating decisions such as those related to marketing, production, R&D, and human resource management may or may not be centralized depending on the strategy of the firm.

Example

Subway is an American based fastest-growing restaurant franchise in the world that sells sandwiches and salads. As of October 2019, Subway was present in 41,512 locations in more than 100 countries. Subway gives local stores control over hiring. The headquarters makes decisions about things such as menu and marketing.

Source: ICFAI Research Center

Firms pursuing a global standardization strategy should decide how to disperse the value creation activities around the globe so that experience curve and location economies are realized. The head office must make decisions about where to locate production, R&D, marketing, etc. In addition, the globally dispersed value creation activities facilitating a global strategy should also be coordinated. All of this creates pressure to centralize some of the operating decisions.

In contrast for firms pursuing a localization strategy, strong pressures are created for decentralizing operating decisions to foreign subsidiaries. Firms that pursue an international strategy maintain centralized control over their core competency and decentralize other decisions to foreign subsidiaries.

The situation in firms pursuing a transnational strategy is more complex. The realization of location and experience curve economies require some degree of centralized control over global production centers. However, the need for local responsiveness dictates decentralization of many operating decisions to foreign subsidiaries. Thus in such firms, some decisions are centralized and some are decentralized. In addition, global learning based on multidirectional transfer of skills between subsidiaries and between subsidiaries and the corporate center is a key feature of a firm pursuing a transnational strategy. The concept of global learning is predicated on the belief that foreign subsidiaries within a multinational firm have significant freedom for developing their own competencies and skills. These can then be leveraged to benefit other parts of the organization. To avail this freedom, a subsidiaries degree of centralization is required. For this reason, firm pursuing a transnational strategy requires high degree of decentralization.

8.4.5 Horizontal Differentiation

Horizontal differentiation concerns how the firm decides dividing itself into subunits. The decision is made on the basis of function, type of business, or geographical area. One of these predominates in many firms but in some firms, more complex solutions are adopted.

Example

Zappos, the online shoe and clothing store. Since 2014, Zappos has instituted a controversial management structure called holacracy, which abolished traditional corporate hierarchy in favour of self-governance and did away with "Titles". Zappos CEO Tony Hsieh compares his organization structure to that of a city: Zappos more like a city, and less like a bureaucratic corporation. In a city, people and businesses are self-organizing. We're trying to do the same thing by switching from a normal hierarchical structure to a system called Holacracy, which enables employees to act more like entrepreneurs and self-direct their work instead of reporting to a manager who tells them what to do. These are customizable self-management practices, where roles are defined around work, authority is distributed and the organization in regularly updated in small iterations.

Source: ICFAI Research Center

8.4.6 Structure of Domestic Firms

Most firms begin with no formal structure and are run by an entrepreneur or a small group of individuals. As they grow, the management demands become too great for an individual or a small team of individuals to handle. At this point, the organization is split into functions reflecting the value creation activities of the firm. These functions are coordinated and controlled by the top management. Decision making in this function is centralized.

Horizontal differentiation may be needed if the firm significantly diversifies its product offering, which takes the firm into different business areas. In such circumstances, the functional structure becomes too clumsy. Problems of coordination and control arise when different business areas are managed within the functional structure framework. It becomes difficult to identify the profitability of each distinct business area. Supervising value creation activities of several business areas is also difficult.

To solve the problems of coordination and control, firms move to product divisional structure from the functional structure.

8.4.7 The International Division

Firms that expand abroad initially often group their international activities into an international division. This is in case of firms organized on the basis of functions and organized on the basis of product divisions. Despite the firm's domestic structure, its international division tends to be organized on geography.

Though the international division is widely used, it can give rise to some problems. Its dual structure contains potential for conflict and coordination problems between domestic and foreign operations. One problem with the international division structure is that the heads of foreign subsidiaries are not given as much as voice as given to the heads of domestic functions or divisions. Rather, the head of the international division is assumed to have the ability to represent the interests of all countries to headquarters. This effectively demotes managers of each country to the second tier of the firm's hierarchy, which is inconsistent with a strategy of trying to expand internationally and build a multinational organization.

The lack of coordination between domestic operations and foreign operations can inhibit worldwide introduction of new products, the transfer of core competencies between domestic and foreign operations, and the consolidation of global production at key locations for realizing experience curve and location economies.

Due to these problems, many firms that expand internationally abandon this structure and adopt one of the worldwide structures.

8.4.8 Worldwide Area Structure

A worldwide structure is favored by firms with a low degree of diversification and a domestic structure based on functions. Under this structure, the world is divided into geographic areas. An area is a country or group of countries. Each area is a self-contained, largely autonomous entity with its own set of value creation activities. Strategic decisions and operations authority related to these activities are decentralized to each area, with headquarters retaining authority for financial control and overall strategic direction of the firm.

The worldwide structure facilitates local responsiveness. As decision-making responsibilities are decentralized, each area can customize marketing strategy, product offerings, and business strategy to the local conditions. However, this structure encourages fragmentation of the organization into highly autonomous activities. This makes realization of experience curve and location economies and transfer of core competencies and skills between areas difficult. In other words, the worldwide area structure is consistent with a localization strategy but make it difficult to realize gains associated with global standardization.

Example

Starbucks's splits its operations into three core territories – Americas, EMEA and China/Asia-Pacific – with a geographic head for each territory (for instance, the president of EMEA operations). Within North America, the geography is further broken down into Western, Northwest, Southeast and Northeast regions. Each region has its own senior executive who sets the operating strategy for the stores within the region. These executives have the flexibility to adjust policies to suit the particular needs of the local market. Ultimately, they report to the territory head for their wider geographic area and follow the corporate objectives set by Head Quarters.

Source: ICFAI Research Center

8.4.9 Worldwide Product Divisional Structure

A worldwide product division structure is adopted by firms that are reasonably diversified and originally had domestic structures based on product divisions. In a domestic product divisional structure, each division is self-contained, largely autonomous entity with total responsibility for its value creation activities. The headquarters retains responsibility for the financial control and overall strategic development of the firm.

Underpinning the organization is a belief that the value creation activities of each product division should be coordinated by that division worldwide. Thus, the worldwide product divisional structure is designed for overcoming the problems related to coordination that arise with the international division and worldwide area structures. The worldwide product division structure enhances consolidation of value creation activities at key locations essential for the realization of experience curve and location economies. It also facilitates the transfer of core competencies within the worldwide operations of the division and the concurrent worldwide introductions of new products. The major problem with this structure is that it gives limited voice to country or area managers, since they are seen as docile to product division managers. This may result in lack of local responsiveness and can lead to performance problems.

Example

Unilever is divided into components based on their product focus. For example, the company has a division for personal care products, a division for home care products, a division for Foods and another division for Refreshments. This enables Unilever to manage the development, manufacturing, distribution and sale of its consumer goods. Thus the company maintains a structure that addresses corporate needs in terms of managing product types across the world.

Source: ICFAI Research Center

8.4.10 Global Matrix Structure

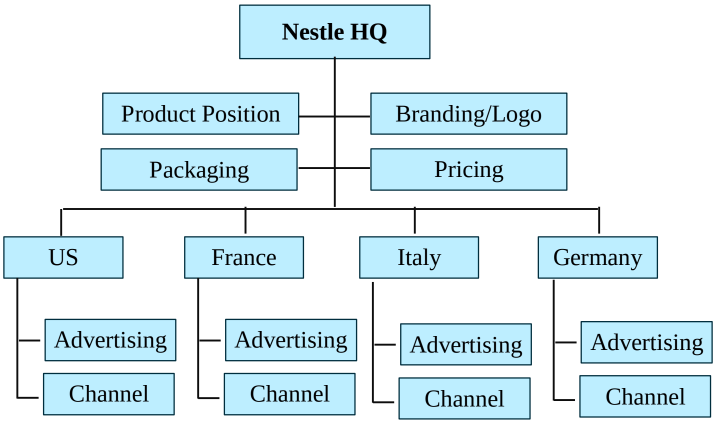
Some firms have made attempts to cope with the conflicting demands of a transnational strategy by using a matrix structure. In a global matrix structure, horizontal differentiation proceeds along two dimensions such as product division and geographic area. The responsibility to operate decisions related to a particular product should be shared by the product division and various areas of the firm. It is believed that the dual decision making responsibility enables a firm to achieve its objectives. In a classic matrix structure, the idea of dual responsibility can be reinforced by giving product divisions and geographical areas equal status within the organization. Thus individual managers belong to two hierarchies – a divisional hierarchy and an area hierarchy and have two bosses – a divisional boss and an area boss.

In practice, the global matrix structure is clumsy and bureaucratic. It may require so many meetings that the work will not be done. The area and product division may slow the decision making process and may produce an inflexible organization that could be unable to respond to market shifts or to innovate. The dual hierarchy may also lead to conflicts and power struggles between the area and product divisions. The most difficult thing in this structure would be ascertaining the accountability as one side may always blame the other side. Thus firms pursuing a transnational strategy build flexible matrix structures based on enterprise wide management knowledge networks, and a shared vision and culture.

Example

Nestle as a decentralized organization permits to subordinate branches to enjoy a proportionately high-level of independence. Its 7 global product groups integrate the activities of all the operating divisions in its group to transfer and leverage distinctive competencies to increase profitability. As a result of this, the Managers in the Candy Product group began orchestrating the marketing and sale of Rowntree Candy products. Similarly all divisions within a country into a Strategic Business Unit (SBU) led by SBU Managers who would link, coordinate and oversee the activities - share in joint purchasing, marketing and sales activities.

Contd….



All this resulted in savings by reducing the nationwide sales offices and suppliers of packaged materials. Finally, the 7 global products activities are integrated with the operations of Nestle's country-based SBU. As a result of this, though Nestle still makes major strategy decisions at the headquarter level, daily operations are left up to subordinate branches to derive and perform. The responsibility for operating decisions is push down to local units.

Source: ICFAI Research Center

Activity 8.1

XYZ Electronics Ltd., a lighting company in India, had a functional structure. The company diversified into medical systems and consumer electronics. The diversification made the functional structure too clumsy. The company also faced problems related to coordination and control. Which divisional structure should the company adopt in order to solve its problems? Also state the benefits of the structure that the company would adopt.

Answer:

8.4.11 Integrating Mechanisms

A firm has to identify some means for coordinating the subunits. One way to achieve coordination is through centralization. However, centralization will not be effective if the coordination task is complex. Higher-level managers who are responsible for achieving coordination can get overwhelmed with the volume of work required for coordinating the activities of several subunits, especially when the subunits are large, diverse, and/or geographically dispersed. In this case, firms look toward integrating both formal and informal mechanisms for achieving coordination.

Example

In 2021, Havas Worldwide India (a media and marketing company) has restructured its senior leadership team. Sengupta was promoted as Head – All Business Units Group (Havas Group Companies). Henceforth, he would work closely with all the leadership teams of the Havas Group companies in a collaborative manner to drive organizational growth.

Here, establishing integrating mechanism is shown as a dimension of organizational structure. Havas Group has established an integrating mechanism by appointing Sengupta to work with all business units' leadership teams.

Source: ICFAI Research Center

8.4.12 Strategy and Coordination in International Business

The need for coordination between subunits varies with the firm's strategy. The need for coordination is lowest in firms pursuing a localization strategy, is higher in international companies, still higher in global companies, and highest of all in transnational companies. Firms pursuing a localization strategy are chiefly concerned with local responsiveness and are likely to adopt a worldwide area structure in which each has considerable autonomy and its own set of value creation functions. As each area is set up as a stand-alone entity, the need for coordination between areas is minimized.

Firms pursuing an international strategy have a higher need for coordination and they try to profit from transferring core competencies and skills between units at home and abroad. Coordination is essential to support transfer of skills and product offerings between units. The need for coordination is also high in firms pursuing a global standardization strategy. Achieving experience and location economies involves dispersing value creation activities to different locations around the globe. The resulting global web of activities needs to be coordinated for ensuring smooth flow of inputs into the value chain, smooth flow of semi-finished goods through the value chain, and smooth flow of finished goods to markets worldwide.

The need for coordination is greatest in transnational firms, which simultaneously pursue experience curve and location economies, local responsiveness, and multidirectional transfer of skills and core competencies among all sub-units of the firm. A transnational strategy also requires coordination between foreign subsidiaries and the globally dispersed value creation activities of the firm to ensure that any marketing strategy and product offering is customized to local conditions.

Example

The 'Non-zero-sum' management approach of Google created a flexible organizational structure that emphasizes less on reporting relationships but more on the flow of communication in all directions to best utilize the talent of cross-functional teams in responding to work-related issues and completing the project quickly.

Here, coordination in international business is the aspect of international business strategy that Google followed through its cross-functional team culture.

Source: ICFAI Research Center

8.4.13 Impediments to Coordination

Managers of various subunits have different orientations, partially because they have different tasks. For instance, marketing managers are concerned with issues related to marketing such as pricing, promotion, distribution, and market share whereas production managers are concerned with issues related to production such as capacity utilization, cost control, and quality control. These differences may inhibit communication between managers.

Differences in orientations of sub-units also arise from differing goals, which may often lead to conflict.

Such impediments to coordination are not unusual in any firm, but can get problematic in the multinational enterprise with abundant subunits at home and abroad. Differences in orientation of subunits are often reinforced in multinationals by the separation of time zone, distance, and nationality between managers of the subunits.

8.4.14 Formal Integrating Mechanisms

The formal mechanisms used for integrating subunits differ in complexity from simple direct contact and liaison roles, to teams, to a matrix structure. Generally, the greater the need for coordination, the more complex the formal integrating mechanisms need to be.

The simplest integrating mechanism is the direct contact between subunit managers. In this mechanism, the managers of various subunits contact each other whenever they have a common concern. However, direct contact may not be effective if the managers belong to differing orientations.

Example

Godrej Consumer Products has a policy called 'learning café' for its senior managers/India business heads. The policy encourages the business heads to connect with its young managers over the forum and build better accessibility and connections.

Contd….

Here, formal integrating mechanism is the aspect of international business strategy that is shown in the 'learning café' policy. Godrej Consumer Products constructed a formal integrating mechanism to encourage its senior managers to build a connection with young managers.

Source: ICFAI Research Center

Liaison roles are a bit more complex. When the volume of contacts between subunits increases, coordination can be improved by giving a person in each subunit responsibility for coordinating with another subunit on a regular basis. Through these roles, the people involved establish a permanent relationship. This helps in attenuating the impediments to coordination.

When the need for coordination is greater, firms tend to use temporary or permanent teams consisting of individuals from the subunits that need to achieve coordination. These teams typically coordinate product development and introduction but they are also useful when any aspect of strategy or operations requires coordination of two or more subunits. Product development and introduction teams include personnel from R&D, marketing, and production. The resulting coordination aids product development tailored to the needs of the consumers and that can be produced at reasonable cost.

When the need for integration is very high, firms may institute a matrix structure, in which all roles are viewed as integrating roles. The matrix structure is designed to facilitate maximum integration among subunits. The most common matrix in multinational firms based on worldwide product divisions and geographical areas. This results in the achievement of high-level of integration between the product divisions and the areas, that is, in theory; the firm pays close attention to pursuit of location and experience curve economies as well as local responsiveness.

In some multinationals, matrix structures are complex as they structure the firm into geographical areas, worldwide product divisions, and functions, all of which directly report to the headquarters. Such a matrix structure, in addition to facilitating local responsiveness and experience curve and location economies, fosters transfer of core competencies within the organization.

Matrix structures tend to be bureaucratic, inflexible, and are characterized by conflict. For such a structure to work it needs to be a little flexible and should be supported by formal integrating mechanisms.

8.4.15 Informal integrating mechanisms

To avoid problems associated with formal integrating mechanisms, firms with a high need for integration have experimented with an informal integrating mechanism –knowledge networks that are supported by an organizational culture that values teamwork and cross-unit cooperation. A knowledge network is "a network for transmitting information within an organization that is based not organization structure, but on informal contacts between managers' enterprise and on distributed information systems." The strength of on formal within a knowledge network is that it can be used as a non-bureaucratic channel for flow of knowledge within a multinational enterprise. Managers at different locations need to be linked indirectly for a network to exist.

Networks can be established using two techniques – information systems and management development policies. For providing the foundation for informal knowledge networks, firms use their distributed computer and telecommunications information systems. Electronic mail, video conferencing, web-based search engines are spread over the globe to get to know each other, to publicize and share best practices, and identify contacts that might help in solving a particular problem. For instance, Wal-Mart used an intranet system for communicating ideas related to its merchandising strategy between stores located in different locations.

Some firms develop informal networks by using management development programs. Managers are rotated through various subunits regularly to build their informal networks and management education managers bring manager of subunits together in a single location for getting acquainted with each other.

Knowledge networks themselves cannot achieve coordination if managers of subunits persist in pursuing sub-goals that are at variance with the goals of the firm. Thus managers should share a commitment to the same goals for a knowledge network to function properly. To eliminate this flaw, firms should have a strong organizational culture that promotes cooperation and teamwork.

8.5 Control Systems and Incentives

A major mission of a firm's leadership is to control the various subunits of a firm – whether they are defined on the basis of function, geographic area, or product division – to ensure that their actions are consistent with the overall strategic and financial objectives of the firm. This can be achieved with the help of various control and incentive systems.

8.5.1 Types of Control Systems

Multinational firms use four different types of control – personal controls, bureaucratic controls, output controls, and cultural controls.

Personal Controls

Personal controls are controlled by personal contact with subordinates. This is widely used in small firms where subordinates' actions are under direct supervision. It also structures the relationships between managers at different levels in the multinational enterprise. For instance, Jack Welch, former CEO of General Electric had one-to-one meetings with the heads of all GE's major businesses. These meetings he used to probe about the strategy, structure, and financial performance of their operations. In doing so, he exercised control over these managers as well as on their strategies.

Example

Elon Musk, the founder of Paypal and Spacex runs his meetings at Tesla which involves no more than four to six executives. When Musk holds meetings, he expects his executives to break down a topic into its molecular facts and then present those in a coherent way. He would run those meetings like he would run a quiz show. He asks participants questions and expects confident answers. One misstep and you're out. Every attendee knows this. He says that questions like these can help you trim your meeting size down to must-have attendees--allowing everyone else to focus on more productive work. His intense demand that the executives put in whatever time is necessary on preparation represent his efforts to maximize the effectiveness of the meetings he can’t avoid.

Source: ICFAI Research Center

Bureaucratic Controls

Bureaucratic control is control through rules and procedures that directs the actions of subunits. The most important bureaucratic controls in subunits are capital spending rules and budgets. Budgets are “essentially a set of rules for allocating a firm’s financial resources.” The budget specifies how much the subunit may spend. Capital spending rules requires the management at the headquarters to approve any capital expenditure by a subunit that surpasses a certain amount.

Output Controls

Output controls involve setting goals for subunits for achieving and expressing those goals in terms of relatively objective performance metrics such as productivity, market share, profitability, growth, and quality. The performance of managers of the subunits is judged on the ability to achieve these goals. If goals are met or exceeded, subunits managers are rewarded. If the goals are not met, top management usually intervenes to find out why and take appropriate corrective action. Thus control is achieved by comparing actual performance against targets and taking corrective action when needed.

Cultural Controls

Cultural controls exist when employees buy into the value systems and norms of the firm. Employees tend to control their own behaviors which reduce the need for direct supervision. In a firm with a strong culture, self-control reduces the need for other control systems.

8.5.2 Incentive Systems

Incentives refer to “the devices used to reward appropriate employee behavior.” Employees receive incentives in the form of annual bonus. Incentives are tied to the performance metrics used for output controls. For instance, setting targets linked to profitability might be used to measure the subunit’s performance. Incentives vary depending on the type of employees and their tasks. Incentives for employees working on the factory floor would vary from the incentives given to senior managers. The basic principle is to ensure that the incentive scheme for an employee is linked to the output target that he/she has control over and can influence.

The successful execution of a strategy in a multinational often requires significant cooperation between managers in different subunits. The managers can be encouraged to cooperate with each other by linking incentives to performance at higher level in the organization.

The incentive systems in a multinational often have to be adjusted to account for national differences in institutions and culture. Incentive systems used in the US might not be allowed or even work in other countries.

It is important for managers to recognize that incentive systems have unintended consequences. Managers have to carefully think that through exactly what behavior certain incentives encourage.

Example

Hilcorp Energy Company is an oil exploration company Headquartered in Houstan, Texas. Hilcorp Energy Company runs a program that is tied to companywide targets over a series of five-year periods. From 2006 to 2011, for example, the target was to double the production rate from 40,000 boe/day to 80,000 boe/day, to double reserves from 125 million boe to 250 million boe, and to double the value of the business from $1 billion to $2 billion. Boe means "barrels of oil equivalent per day". When the 2011 goal was met, 400 employees got $50,000 to spend on a car—the same amount for everyone who were there the full five years. The company once again promised the staff in 2010 that if the company doubles its production rate and reserves by 2015 (target was to reach 120,000 boe/day, 500 million boe, and $6 billion value), every employee will get a check for $100,000. The target for the period 5 year period ending 2020 is 275,000 boe/day. The reward will be the cash equivalent of $75,000 for anyone who was employed for the entire five years. Hilcorp also pays a bonus linked to overall company performance – production rate, midstream income, reserves, and operating costs. The annual bonus payout is up to 60 percent of salary and is the same number for every employee. Everything the company does is designed to foster a sense of ownership among the employees, so that their goals are aligned with those of the company.

Source: ICFAI Research Center

Control Systems, Incentives, Strategy in the International Business

Performance ambiguity is the key to understand the relationship between international strategy, control systems, and incentive systems. Performance ambiguity exists when the causes for poor performance of a subunit are not clear. This occurs when there is a high degree of interdependence between subunits within an organization.

In firms pursuing a localization strategy, each national operation is a stand-alone entity and can be judged on its own merits. The level of performance ambiguity is low. In firms pursuing an international strategy, the level of interdependence is somewhat higher. In firms pursuing a globalization strategy, many of the activities are interdependent and thus performance ambiguity is high. The level of performance ambiguity is highest in transnational firms. The high level of integration within transnational firms implies a high degree of joint decision making and the resulting interdependencies leads to poor performance.

8.6 Processes

Processes can be defined as "the manner in which decisions are made and work is performed within the organization." Processes are found at different levels of the organization. There are processes for formulating strategy, allocating resources, evaluating new product ideas, handing customer inquiries and complaints, improving product quality, evaluating employee performance, etc. Often, valuable skills or core competencies of a firm are embedded in its processes. Efficient and effective processes lower the costs of value creation and add additional value to a product. For instance, General Electric's process of Six Sigma is used for quality improvement.

Many processes cut across functions, or divisions, and require cooperation between individuals in different subunits. For instance, product development processes require employees from R&D, manufacturing, and marketing to work in a cooperative manner to ensure that new products are developed with market needs in mind and designed in such a way that it is manufactured at a low cost.

Many processes in a multinational enterprise cut not only across organizational boundaries but also across national boundaries. For instance, designing a new product may require R&D personnel from California, production people located in Taiwan, and marketing personnel located in Asia, America, and Europe.

It is important for a multinational enterprise to recognize that valuable new processes that might lead to a competitive advantage can be developed anywhere within the firm's global network of operations. It is also important to leverage valuable processes. This requires both formal and informal integrating mechanisms such as knowledge networks.

8.7 Organizational Culture

Culture refers to "a system of values and norms that are shared among people." Values are "abstract ideas about what a group believes to be good, right, and desirable." Norms mean "the social rules and guidelines that prescribe the appropriate behavior in particular situations." Values and norms are the behavioral patterns in an organization that new employees are encouraged to follow.

8.7.1 Creating and Maintaining an Organizational Culture

The culture of an organization comes from several sources. First, the founders or leaders have a profound impact on the organizational culture often imprinting their own values in the culture. For instance, Lincoln Electric, a US-based wielding equipment manufacturer, where the values of James Lincoln became the core values at Lincoln Electric.

Another important influence on organizational culture is the broader social culture of the nation where the organization is founded. For instance, many American firms reflect the values of the American culture. Thus organizational culture is influenced by national culture.

A third influence on organizational culture is the history of the enterprise, which shapes the value of the organization. For instance, at Philips NV, the culture was shaped by the history of the company. The company operated with a culture that placed high value on the independence of national operating companies.

Culture can be maintained by a variety of mechanisms such as hiring and promotional practices of the organization, socialization processes, reward strategies, and communication strategy. The goal is to recruit people whose values are consistent those of the organization. To reinforce values, a company may promote individuals whose behavior is consistent with the core values of the organization. Socialization can be formal and informal. Formal socialization includes training programs that educate employees about the core values of the organization. Informal socialization may include friendly advice from peers and bosses. Merit review processes are linked to the company values, which further reinforces cultural norms. As for communication strategy, companies with a strong culture devote lot of attention for communicating key values in corporate mission statements, communicating them to employees, and using them to guide difficult decisions.

8.7.2 Organizational Culture and Performance in International Business

A culture that leads to high performance in the home nation may not be imposed in its foreign operations. An organization has to establish values in the new enterprise than changing the values of an established enterprise. Another solution is that the firm has to devote lot of time and attention to transmit its organizational culture to its foreign operations. A third solution is to recognize that it is essential to change some aspects of the firm so that it better fits the culture of the host nation.

The need for a common organizational culture that is same across a multinational's global network of subsidiaries varies probably with a firm's strategy. Shared values and norms can facilitate coordination and cooperation between individuals belonging to different subunits. A strong common culture may lead to goal congruence and can attenuate problems arising from performance ambiguities, interdependence, and conflict among managers of different subsidiaries.

8.8 Synthesis: Organizational Architecture and Strategy

Organizational architecture varies with the organizations strategy.

8.8.1 Localization Strategy

Firms pursuing a transnational strategy focus on local responsiveness and operate with worldwide area structures where the operating decisions are decentralized to subsidiaries that are functionally self-contained. The need for coordination between subunits is low. In such firms there is no need for high integrating mechanisms. The lack of interdependence implies that level of performance ambiguity in such firms is low, as are the cost of controls. Thus headquarters can manage foreign operations by relying on bureaucratic and output controls and a policy of management by exception. Incentives can be linked to performance metrics at the level of country subsidiaries. As the need for coordination and integration is low, the need for common organizational culture and processes is also quite low.

8.8.2 International Strategy

Firms pursuing an international strategy attempt to create value by transferring core competencies from home to foreign subsidiaries. If they are diverse, most firms operate with a worldwide product division structure. Headquarters maintains centralized control over the core competency of the firm. Other operating decisions are decentralized within the firm to subsidiary operations in each country.

The need for coordination is moderate in such firms. The integrating mechanisms are not that extensive. The low level of interdependence results in low level of performance ambiguity. These firms get with bureaucratic and output controls and with incentives that focus on performance metrics at the level of country subsidiaries. The need for a common organizational culture and common processes is not that great. An exception is that when the core competencies or skills of the firm are embedded in process and culture, the firm needs to pay close attention to transfer those processes and culture from the corporate center to the country subsidiaries. The level of complexity in such firms is not that great.

8.8.3 Global Standardization Strategy

Firms pursuing a global standardization strategy focus on realization of experience curve and location economies. If they are diversified, these firms operate with a worldwide product division structure. To coordinate the firm's globally dispersed value creation activities; headquarters maintain control over most of the operating decisions. The need for integration in such firms is high. Thus these firms operate with formal and informal integrating mechanisms. The resulting interdependencies can lead to significant performance ambiguities. Such firms stress on building a strong organizational culture that facilitates coordination and cooperation. They use incentive systems that are linked to performance metrics at the corporate level. The integration of such firms is complex than firms pursuing a localization or international strategy.

8.8.4 Transnational Strategy

Firms pursuing a transnational strategy focus on achieving location and experience curve economies, local responsiveness, and global learning. These firms may operate with a matrix structure in which both geographic areas and product divisions have significant influence. The need to coordinate a globally dispersed value chain and to transfer core competencies creates pressures for centralizing some operating decisions. The need to be locally responsive creates pressures for decentralizing some operating decisions to national operations. Consequently, these firms tend to mix high degrees of centralization for some operating decisions with high degrees of decentralization for other operating decisions.

The need for coordination is high in transnational firms. This is reflected in the use of formal and informal integrating mechanisms, including formal matrix structures and informal management networks. Such integration results in high interdependence among subunits and this may cause significant performance ambiguities, which increases cost of control. This can be reduced by cultivating a strong culture and establishing incentives that promote cooperation between subunits.

Environment, Strategy, Architecture and Performance

For a firm to achieve high performance, a fit between strategy and architecture is essential. To succeed in this, two conditions have to be met. First, the firm's strategy should be consistent with the environment in which it operates. Second, the organization architecture of a firm must be consistent with its strategy.

If the strategy does not fit the environment, the firm may face performance problems. If the architecture does not fit the strategy, the firm will again face performance problems. Thus a firm has to survive a fit of its environment, strategy, and its organizational architecture.

Activity 8.2

Cisel Corp. (Cisel), a semiconductor manufacturer operated with a localization strategy where it decentralized its operating decisions to its autonomous foreign subsidiaries. However, of late, the industry in which Cisel operated had revolutionized due to declining trade barriers, technological changes, and emergence of low-cot Chinese competitors that used a goba strategy. In this context, which strategy would fit the company's architecture? Also state the reasons for the same.

Answer:

8.9 Organizational Change

Multinationals periodically alter their architecture to conform to the changes in the environment in which they compete and the strategy they pursue.

8.9.1 Organizational inertia

Within most of the organizations are strong inertia forces. These forces come from many sources. The distribution of influence and power is an organization is one source of inertia. The power and influence enjoyed by individual managers is part of their role in the organizational hierarchy, as defined by the structural position. Most of the substantive changes in the organization require a change in structure and a change in power and influence within the organization. As a result of organizational changes, some individuals see an increase in their power and influence and vice versa.

The existing culture is another source of inertia expressed in norms and value systems. Value systems reflect beliefs that are deeply held and are hard to change.

Organizational inertia also arises from preconceptions of senior managers about the appropriate business model or paradigm. When a given paradigm has worked well in the past, mangers may have trouble accepting that it may longer be appropriate.

Institutional constraints may also be a source of inertia. National regulations including local rules and policies pertaining to layoff may make it difficult for multinational firms to alter its global value chain.

Example

Don Harrison, a popular Change Management Consultant, said that the resistance to change in the organization is sometimes cumulative. If in the board room, the statement like 'We have tried this before and it didn't work' comes, this means they have not adapted to change.

Contd….

The resistance encountered in the present time may be due to a change that failed in the past. But in reality, poorly managed change implementations have a long-term residual impact, which leaders might fail to recognize. This is an organizational inertia, an aspect of international business strategy, is shown above. It shows how the poor change management implementation in the past cumulatively can become one of the sources of organizational inertia.

Source: ICFAI Research Center

8.9.2 Implementing Organizational Change

Though all organizations suffer from inertia, the complexity and global spread of multinationals might make it difficult for them to change their strategy and structure for matching new organizational realities. Yet globalization in many industries has made it critical than what multinationals do that. Declining trade barriers to cross-border trade and investment have led to changes in the nature of the competitive environment. Increasing cost pressures have required multinationals to respond by streamlining their operations to realize economic benefits associated with experience curve and location economies and with transfer of skills and competencies within the organization. At the same time, local responsiveness remains an important source of differentiation. To survive in this competitive environment, multinationals change their strategy as well as their architecture. The basic principles for successful organizational change can be summarized as follows: (1) unfreeze the organization, (2) move the organization though a new state, and (3) refreeze the organization into a new state.

Unfreezing the Organization

Due to forces of inertia, incremental change is often no change. Those whose power is threatened by change can also resist change easily. Thus the theory of change maintains that effective change requires "unfreezing" the established culture of an organization and change the distribution of influence and power. Shock therapy to unfreeze the organization might include plant closure deemed uneconomic or the announcement of a striking structural organization. It is also important to realize that change does not take place unless senior managers are committed to it. Senior managers must articulate the need for change so that employees understand why it is being pursued and the benefits that could be reaped from successful change.

Moving to the New Site

Once an organization is unfrozen, it should be moved to a new state. Movement requires taking some action such as closing operations; reorganizing the structure; reassigning responsibilities; changing control, incentive and reward systems; redesigning processes; and letting people go who act as impediments to change. The movement is successful when it is done with sufficient speed. For rapid movement employees can be involved in the change effort.

Example

In 2022, Adani Wilmar, a popular joint venture FMCG company in India, has gone for an IPO to raise funds for the expansion of the business and thereby made a public limited company. The company was founded in 1999. After the two decades of its presence, it has become one of the leading FMCG players in the Indian food market with revenue of Rs.37,000 crore in 2021 alone. The company is aggressively looking to expand its footprint through acquisitions.

Here, moving to the new site, a principle of organizational change, is illustrated above.

It shows that Adani Wilmar has moved from a state of private company into a public limited company through IPO. This shows moving to the new state principle of organizational change.

Source: ICFAI Research Center

Refreezing the Organization

Refreezing the organization takes a longer time. It may require a new culture to be established, while the old one is dismantled. Thus refreezing requires that employees be socialized into the new way of doing things. For achieving this, companies use management education programs. However, these programs are not enough; hiring policies should also be changed to reflect the new realities where such individuals are hired whose own values are consistent with the new culture the firm is trying to build. Similarly, control and incentive systems should also be consistent with the new realities of the organization else change will not take place.

Check Your Progress - 1

1. __________ refers to the totality of a firm's organization, including formal organizational structure, control systems and incentives, organizational culture, processes, and people.
   a. Organizational processes
   b. Organizational control
   c. Organization architecture
   d. Organizational structure
2. __________refers to the norms and value systems that are shared among the employees of an organization.
   a. Organizational structure
   b. Organization architecture
   c. Organizational change
   d. Organizational culture

3. __________in a firm determines where the power and responsibility of decision making is concentrated in the hierarchy.
   a. Organization architecture
   b. Organization design
   c. Vertical differentiation
   d. Horizontal differentiation
4. Which of the following are arguments for centralization?
   i. Facilitates coordination
   ii. Ensures that decisions are consistent with the organizational objectives
   iii. Gives top-level managers means to bring about needed organizational changes
   iv. Avoids duplication of activities.
   v. Allows flexibility
   a. i, ii, iii, and iv
   b. ii, iii, iv, and v i,
   c. iii, iv, and v i, ii,
   d. iv, and v
5. Which of the following are arguments for decentralization?
   i. Top management can focus on critical issues
   ii. Motivational research, allows for flexibility
   iii. Better decision making, increases control
   iv. Decreases control, allows inflexibility
   v. Avoids duplication of activities
   a. i, iii, and v
   b. ii, iv, and v
   c. i, ii, and iii
   d. iii, iv, and v
6. In which structure the world is divided into geographic areas?
   a. Worldwide area structure
   b. International division
   c. Worldwide product divisional structure
   d. Global matrix structure
7. A _is adopted by firms that are reasonably diversified and originally had domestic structures based on product divisions.
   a. Worldwide product divisional structure
   b. Global matrix structure
   c. International division
   d. Worldwide area structure

8. In a _______ horizontal differentiation proceeds along two dimensions such as product division and geographic area.
   a. International division
   b. Global matrix structure
   c. Worldwide area structure
   d. Worldwide product division structure
9. The need for coordination is greatest in firms pursuing which of the following strategies?
   a. Transnational
   b. Localization
   c. Global standardization
   d. International
10. A knowledge network can be established using which of these techniques?
    i. Information systems
    ii. Management development policies
    iii. Electronic commerce
    iv. Decision support systems
    v. Accounting systems
    a. i and ii
    b. iii and iv
    c. iv and v
    d. ii and iii
11. ____are controlled by personal contact with subordinates
    a. Personal controls
    b. Bureaucratic control
    c. Output control
    d. Cultural control
12. ___________is control through rules and procedures that directs the actions of subunits.
    a. Output control
    b. Cultural control
    c. Personal controls
    d. Bureaucratic control
13. ___________involve setting goals for subunits for achieving and expressing those goals in terms of relatively objective performance metrics such as productivity, market share, profitability, growth, and quality.
    a. Cultural control
    b. Output control
    c. Personal control
    d. Bureaucratic control

14. __________exist when employees buy into the value systems and norms of the firm.
    a. Cultural control
    b. Bureaucratic control
    c. Output control
    d. Personal control
15. ___refer to the devices used to reward appropriate employee behavior.
    a. Control systems
    b. Incentives
    c. Value system
    d. Norms
16. ___ are manners in which decisions are made and work is performed within the organization.
    a. Incentives
    b. Processes
    c. Policies
    d. Knowledge networks
17. ___refers to a system of values and norms that are shared among people.
    a. Culture
    b. Norms
    c. Values
    d. Beliefs
18. __________ are abstract ideas about what a group believes to be good, right, and desirable.
    a. Beliefs
    b. Norms
    c. Culture
    d. Values
19. __________mean the social rules and guidelines that prescribe the appropriate behavior in particular situations.
    a. Values
    b. Beliefs
    c. Norms
    d. Culture
20. Culture can be maintained by which of the following mechanisms?
    a. Hiring and promotional practices
    b. Socialization processes
    c. Reward strategies and communication strategy
    d. All of the above

21. Firms pursuing a transnational strategy operate with which structure?
    a. Worldwide area structure
    b. Global matrix structure
    c. Worldwide product division structure
    d. Geographic area structure
22. Firms pursuing an international strategy operate with which structure?
    a. Worldwide area structure
    b. Worldwide product division structure
    c. Global matrix structure
    d. Geographic area structure
23. Firms pursuing a global standardization strategy operate with which structure?
    a. Worldwide product division structure
    b. Geographic area structure
    c. Worldwide area structure
    d. Global matrix structure
24. Firms pursuing a transnational strategy operate with which structure?
    a. global matrix structure
    b. geographic area structure
    c. worldwide area structure
    d. worldwide product division structure
25. Which of the following are forces of inertia in an organization?
    a. The existing culture in an organization
    b. Preconceptions of senior managers about the appropriate business model or paradigm
    c. Institutional constraints
    d. All of the above

8.10 Summary

- Organizational architecture refers to the totality of a firm's organization, including formal organizational structure, control systems and incentives, organizational culture, processes, and people.
- Organizational structure can be understood in terms of three dimensions – (1) vertical differentiation, which refers to the location of decision making responsibilities within a structure; (2) horizontal differentiation, which refers to the formal organizational division into subunits; and (3) establishing integrating mechanisms, which are mechanisms to coordinate the subunits.
- Multinational firms use four different types of control – personal controls, bureaucratic controls, output controls, and cultural controls. Incentives are devices used to reward appropriate employee behavior.

- Processes are found at different levels of the organization. There are processes for formulating strategy, allocating resources, evaluating new product ideas, handing customer inquiries and complaints, improving product quality, evaluating employee performance, etc.
- The culture of an organization comes from several sources. First, the founders or leaders have a profound impact on the organizational culture often imprinting their own values in the culture. Another important influence on organizational culture is the broader social culture of the nation where the organization is founded. A third influence on organizational culture is the history of the enterprise, which shapes the value of the organization.
- Firms pursuing a transnational strategy focus on local responsiveness and operate with worldwide area structures where the operating decisions are decentralized to subsidiaries that are functionally self-contained.
- Firms pursuing an international strategy attempt to create value by transferring core competencies from home to foreign subsidiaries. If they are diverse, most firms operate with a worldwide product division structure.
- Firms pursuing a global standardization strategy focus on realization of experience curve and location economies. If they are diversified, these firms operate with a worldwide product division structure.
- Firms pursuing a transnational strategy focus on achieving location and experience curve economies, local responsiveness, and global learning. These firms may operate with a matrix structure in which both geographic areas and product divisions have significant influence.
- Within most of the organizations are strong inertia forces. The existing culture is another source of inertia expressed in norms and value systems. Organizational inertia also arises from preconceptions of senior managers about the appropriate business model or paradigm. Institutional constraints may also be a source of inertia.
- The basic principles for successful organizational change can be summarized as follows: (1) unfreeze the organization, (2) move the organization though a new state, and (3) refreeze the organization into a new state.

8.11 Glossary

Culture: Culture refers to a system of values and norms that are shared among people.

Incentives: Incentives refer to the devices used to reward appropriate employee behavior.

Knowledge network: A knowledge network is a network for transmitting information within an organization that is based not on formal organization structure, but on informal contacts between managers within an enterprise and on distributed information systems.

Organizational architecture: Organizational architecture refers to the totality of a firm's organization, including formal organizational structure, control systems and incentives, organizational culture, processes, and people.

Organizational culture: Organizational culture refers to the norms and value systems that are shared among the employees of an organization.

Processes: Processes are the manners in which decisions are made and work is performed within the organization.

Norms: Norms mean the social rules and guidelines that prescribe the appropriate behavior in particular situations.

Values: Values are abstract ideas about what a group believes to be good, right, and desirable.

8.12 Self-Assessment Test

1. Define organizational structure. Explain the various components of organizational structure.
2. Organizational structure can be understood in terms of three dimensions. Explain these dimensions in brief.
3. Multinational firms use four different types of control – personal controls, bureaucratic controls, output controls, and cultural controls. Describe these controls. Also define incentives.
4. Define processes and explain how processes are managed in international business.
5. Explain how organizational culture is created and maintained and its influence in international business.
6. Describe briefly the synthesis of organization architecture and strategy.
7. Explain organizational change and the strategies and tactics for implementing organizational change.

8.13 Suggested Readings/Reference Material

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8.14 Answers to Check Your Progress Questions

1. (c) Organization architecture

Organizational architecture refers to the totality of a firm's organization, including formal organizational structure, control systems and incentives, organizational culture, processes, and people.

2. (d) Organizational culture

Organizational culture refers to the norms and value systems that are shared among the employees of an organization.

3. (c) Vertical differentiation

Vertical differentiation in a firm determines where the power and responsibility of decision making is concentrated in the hierarchy.

4. (c) i, ii, iii, and iv

There are four main arguments for centralization. First, it facilitates coordination. Second, it ensures that decisions are consistent with the organizational objectives. Third, it gives top-level managers means to bring about needed organizational changes by concentrating power and authority in one individual or a management team. Fourth, it avoids duplication of activities that occurs when similar activities are carried on by various subunits within the organization.

5. (c) i, ii, and iii

There are five main arguments for decentralization. First, top management becomes overburdened when the decision making authority is centralized, and this can result in poor decisions. Decentralization gives time to top management to focus on critical issues by delegating routine tasks to lower-level managers. Second, motivational research favors decentralization. Third, decentralization allows for flexibility. Fourth, Decentralization results in better decision making. Fifth, decentralization can increase control.

6. (a) Worldwide area structure

In worldwide area structure, the world is divided into geographic areas.

7. (a) Worldwide product divisional structure

A worldwide product division structure is adopted by firms that are reasonably diversified and originally had domestic structures based on product divisions.

8. (c) Global matrix structure

In a global matrix structure, horizontal differentiation proceeds along two dimensions such as product division and geographic area.

9. (a) Transnational

The need for coordination is greatest in firms pursuing transnational strategy.

10. (a) i and ii

Networks can be established using two techniques – information systems and management development policies.

11. (a) Personal controls

Personal controls are controlled by personal contact with subordinates.

12. (d) Bureaucratic control

Bureaucratic control is control through rules and procedures that directs the actions of subunits.

13. (b) Output controls

Output controls involve setting goals for subunits for achieving and expressing those goals in terms of relatively objective performance metrics such as productivity, market share, profitability, growth, and quality.

14. (a) Cultural controls

Cultural controls exist when employees buy into the value systems and norms of the firm.

15. (b) Incentives

Incentives refer to the devices used to reward appropriate employee behavior.

16. (b) Processes

Processes are manners in which decisions are made and work is performed within the organization.

17. (a) Culture

Culture refers to a system of values and norms that are shared among people.

18. (d) Values

Values are abstract ideas about what a group believes to be good, right, and desirable.

19. (c) Norms

Norms mean the social rules and guidelines that prescribe the appropriate behavior in particular situations.

20. (d) All of the above

Culture can be maintained by a variety of mechanisms such as hiring and promotional practices of the organization, socialization processes, reward strategies, and communication strategy.

21. (a) Worldwide area structure

Firms pursuing a transnational strategy operate with a worldwide area structure.

22. (b) Worldwide product division structure

Firms pursuing an international strategy operate with a worldwide product division structure.

23. (a) Worldwide product division structure

Firms pursuing a global standardization strategy operate with a worldwide product division structure.

24. (a) Matrix structure

Firms pursuing a transnational strategy operate with a matrix structure.

25. (d) All of the above

The forces of inertia in an organization include the existing culture in an organization, preconceptions of senior managers about the appropriate business model or paradigm, and institutional constraints.

Unit 9

Entry Strategies and Strategic Alliances

Structure

"Buy companies with strong histories of profitability and with a dominant business franchise."

- Warren Buffet

9.1 Introduction

The previous unit defined organizational architecture and explained its various components. It then explained the different dimensions of organizational structure. It then discussed different types of control systems and incentives. It then defined processes and how processes are managed in international business. It also discussed how an organizational culture is created and maintained and how it influenced performance of a multinational in international business. It also discussed the synthesis of organizational architecture and strategy. The unit finally discussed organizational change and the strategies and tactics for implementing organizational change.

Firms considering international expansion need to consider two basic decisions – the decision to enter which foreign market, when to enter, and on what scale; and the choice of entry mode. The choice of which markets to enter is driven by an assessment of long-run growth and profit potential. The choice of entry mode is another major issue international businesses need to consider. The various entry modes for serving foreign markets include exporting, licensing, franchising, establishing joint ventures or wholly-owned subsidiaries, or acquiring an established enterprise in the host nation.

This unit will discuss basic decisions a firm considers for foreign expansion. It then goes into explaining the various modes of entering a foreign market. It then discusses how an entry mode is selected. It also discusses the concept of Greenfield ventures and international acquisition, advantages and disadvantages of acquisition and Greenfield ventures. The unit finally discusses strategic alliances, its advantages and disadvantages, and how to make the alliances work.

9.2 Objectives

By the end of this unit, you should be able to:

- Explain the basic decisions considered by firms contemplating foreign expansion.
- Identify the different entry modes for entering a foreign market.
- Describe how an entry mode is selected.
- Analyze the advantages and disadvantages of acquisitions and Greenfield ventures.
- Examine the advantages and disadvantages of strategic alliances, and how to make the alliances work.

9.3 Basic Entry Decisions

A firm has to contemplate three basic decisions for foreign expansion – which markets to enter, when to enter those markets, and on what scale.

9.3.1 Which Foreign Markets to Enter?

The attractiveness of a country as a potential market for an international business depend on balancing the benefit, costs, and risks associated with doing business in that country.

The long-run economic benefits of doing business in a country depends on factors such as market size, purchasing power of consumers in that market, and the likely future wealth of consumers, which depend on the economic growth rates. The markets should be seen in terms of economic growth and living standards when measured by number of consumers. For instance, China and to a lesser extent, India though relatively poor to other developed nations are attractive targets for inward investment. Alternatively, weak growth in Indonesia makes it less attractive a target for inward investment.

The cost and risks associated with doing business in a foreign country are lower in economically advanced and politically stable democratic nations and they are greater in less developed and politically unstable nations.

Others being equal, the benefits-cost-risk trade-off is likely to most favorable in the politically stable developing and developed nations that have free market systems, and where there is no upsurge in either private-sector debt or inflation rates. The trade-off is least favorable in politically unstable developing nations that operate with a command or mixed economy or in developing nations where financial bubbles that are speculative have led to excess borrowing.

Another crucial factor is the value an international business can create in a foreign market. This depends on the suitability of the product offering to that market and the nature of local competition. If the international business offers a product that is not widely available in that market and that satisfies an unmet need, the value of that product will be greater than if the international business offers the same type of product that local competitors and other foreign entrants are already offering. Greater value translates into an ability to charge higher prices and build volume of sales more rapidly.

By taking into consideration such factors, a firm can rank countries in terms of their attractiveness and profit potential in the long-run.

9.3.2 Timing of Entry

Having identified attractive markets, it is important to consider the timing of entry. An entry is early when a firm enters an international market before other foreign firms and the entry is late when a firm enters after other foreign firms have established themselves. The advantages associated with entering a market early are called as first-mover advantages. One first-mover advantage is the ability to preempt rivals and capture demand by establishing a strong brand name. A second advantage is the ability to build sales volume in the country and ride down the experience curve ahead of rivals, giving a cost advantage to the early entrant before the late entrants. The cost advantage may enable the early entrant to cut prices below that of the late entrants, thus driving them out of the market. A third advantage is the ability of early entrants to create switching costs that bind customers to their products and services. Such switching costs make it difficult for late entrants to win business.

Some disadvantages are also associated with entering a foreign market before other international businesses enter. These are referred to as first-mover disadvantages. These advantages may give rise to pioneering costs that an early entrant has to bear that can be avoided by a late entrant. Pioneering costs include the costs of business failure if the firm makes some major mistakes due to its ignorance of the foreign environment. The late entrant may also benefit from observing and learning from the mistakes made by early entrants. An early entrant may also face a severe disadvantage relative to the late entrant, if regulations diminish the value of investments made by an early entrant. This is a serious risk faced by early entrants in developing nations where the rules governing business practices are still evolving.

Example

In 2017, Google acquired Taiwan-based HTC's Pixel Phone division for $1.1 billion. Pixel's acquisition enabled Google to produce its own Pixel smartphones. Google, the company behind Android thus made its own phone and launched it. The Pixel, with its premium build, remarkable camera and high-end price tag, was glossy and chic. But it entered a market already dominated by the likes of Apple and Samsung, two of the most popular phone makers in the world. The covid pandemic has further impacted sales and Pixel's struggle to push sales continues.

Here, strong brand created by early entrants impacted Pixel's sales. Even though Google's Pixel phones were rated high in terms of quality, it struggled to increase sales. Both Apple and Samsung have been in the smartphone market for a very long time and they had created strong brands. While Chinese phones competed in the low-priced segment, Pixel, which was priced high, struggled to compete with Samsung and Apple.

Source: ICFAI Research Center

Scale of entry and Strategic Commitments

Entering a market on a large scale involves commitment of significant resources. It also implies rapid entry. However, some firms enter on a small scale as they do not have the resources essential to enter on a large scale.

The consequences of entering on a significant scale – entering rapidly – are associated with value of ensuing strategic commitments. A strategic commitment has a long-term impact which is difficult to reverse. A major strategic commitment is deciding to enter a foreign market on a significant scale. Strategic commitments such as rapid large scale entry into a market can have an important influence on the nature of competition in the market.

Strategic commitments that are significant are either good or bad. Rather, they tend to alter the competitive playing field and unleash several changes, some of which will be desirable and some will be not. A firm has to consider implications of entering a large-scale market and act accordingly. For instance, a firm has to identify how actual and potential competitors react to the large-scale entry into a market. Also a large-scale entrant is more likely to be able to capture first mover advantages associated with scale economies, demand preemption, and switching costs.

The value of the commitments that flow from rapid large-scale entry into a foreign market must be balanced against the risks that would result and lack of flexibility associated with strategic commitments. But strategic inflexibility also has value.

The benefits of a small-scale entry include balance against the value and risks of the commitments associated with large-scale entry. Small-scale entry allows a firm to learn about the foreign market while limiting the exposure of the firm to that market.

Small-scale entry reduces the risks associated with large-scale entry. But the lack of commitment associated with small-scale entry may make the firm difficult to build market share and capture first-mover advantages.

Activity 9.1

ABC Corporation, a US-based fast food company introduced American-style fast food in its Chinese operations. The company faced lot of problems while introducing the fast food in the Chinese menu. It also incurred several losses as it too time for the Chinese consumer to adapt to the American-style fast food. When the Chinese got accustomed to this food, ABC's rival, FastUS, another US-based fast food chain entered the Chinese market and introduced the American-style fast food and capitalized on the market in China. in this context, identify the advantage and disadvantage for ABC and FastUS. Also state the reasons why ABC's loss was FastUS's gain.

Answer:

9.4 Entry Modes

Once a firm decides to enter a foreign market, it has to consider the mode of entry. Firms can use various entry modes such as exporting, turnkey project, licensing, franchising, establishing joint ventures with a host firm, or setting up a wholly-owned subsidiary in the host country. Each mode of entry has its advantages and disadvantages.

9.4.1 Exporting

Many manufacturing firms commence their global expansion as exporters and later switch to another mode for serving a foreign market.

Advantages

Exporting has two advantages. First, it avoids the substantial costs associated with establishing manufacturing operations in the host country. Second, exporting helps firms achieve location and experience curve economies. The firm can realize substantial scale economies from its global sales volume by manufacturing the product in a centralized location and exporting it to other national markets.

Disadvantages

Exporting has its drawbacks as well. First, exporting from the home base of the firm may not be appropriate if lower-cost manufacturing locations are found abroad. Second, the high costs associated with transportation make exporting uneconomical, particularly for bulk products. Thus firms should manufacture bulk products regionally as it enables the firm to realize some economies from large-scale production and also limits its transportation costs.

Another drawback is that tariff barriers make exporting uneconomical. A fourth drawback is that when a firm delegates its sales, marketing, and service in each country where it does business to another company. The other company can be a local agent or another multinational. Local agents often carry the products of competing firms and so have divided royalties. In such cases, a firm can carry off it marketing job better than the local agents. This problem can be solved by setting up wholly-owned subsidiaries in foreign nations to handle local marketing, sales, and service. This enables the firm to exercise tight control over marketing and sales in the country while reaping cost advantages of manufacturing the product in a single location.

Example

In 2019, India's leading toy maker Funskool inaugurated its third manufacturing unit at the Ranipet industrial cluster. Earlier to this, the company had a manufacturing facility at Goa. John Baby, CEO, Funskool India Ltd said that the company set up the Ranipet unit primarily to focus on international market which witnessed a 50 per cent growth in FY19 while domestic markets are witnessing slow down. Shipping goods from Goa is time consuming and involve huge logistics cost as the consignments have to be taken to Mumbai, which also happens to be a crowded port. Further he added that the company has chosen Ranipet to take strategic advantage of its close proximity to the Chennai port, which would reduce its logistics cost.

Source: ICFAI Research Center

9.4.2 Turnkey Projects

Firms specializing in construction, design, and start-up of turnkey plants are common in some industries. In a turnkey project, the contractor handles every project detail for a foreign client, including training of operating personnel. After the contract is completed, the foreign client is handed the "key" to the plant that is ready for full operation – hence, the term turnkey. This is a mode of exporting process technology to other countries. Turnkey projects are common in industries such as pharmaceutical, chemical, petroleum refining, etc. where complex, expensive technologies are used.

Advantages

The know-how required to run a technologically complex process is a valuable asset. Turnkey projects earn greater returns from these assets. The strategy is useful especially where FDI is limited by regulations of the host-government. A turnkey strategy can also be less risky than conventional FDI. In a country with unstable economic and political environments, a longer-term investment might expose the firm to unacceptable economic and/or political risks.

Disadvantages

Three drawbacks are associated with a turnkey strategy. First, the firm entering a turnkey deal will have no long-term interest in the foreign market. This can be a disadvantage if that country proves to be a major market for the output of the process that has been exported. Second, the foreign enterprise with which a firm enters into a turnkey project may turn to be a competitor. Third, if the process technology of a firm is the source of competitive advantage, then selling this technology through a turnkey project is like selling competitive advantage to actual or potential competitors.

9.4.3 Licensing

A licensing agreement is an arrangement wherein a licensor grants the rights to intangible property to a licensee or another entity for some specific period, and in return, the licensor receives a royalty fee from the licensee. Intangible property includes patent, trademarks, copyrights, formulas, inventions, designs, and processes.

Advantages

A primary advantage of licensing is that the firm does not have to incur the development costs and risks associated with opening a foreign market. Licensing is attractive to firms lacking capital to develop overseas operations. It is also attractive to firms unwilling to commit substantial financial resources to an unfamiliar or politically volatile foreign market. Licensing is used often when a firm wishes to enter a foreign market but is prohibited due to barriers to investment. Licensing is frequently used when a firm has some intangible property that may have some business applications, but it does not want to develop those applications itself.

Disadvantages

Licensing does not give a firm tight control over marketing, manufacturing, and strategy required to realize experience curve and location economies. Licensing involves each licensee setting up its own production operations. This limits the ability of a firm to realize experience curve and location economies by producing a product in a centralized location. When these economies are important, licensing may not be the best way for overseas expansion.

Second, licensing limits a firm from using profit earned in one country to support a different licensee in another country.

A third problem with licensing is the risk associated with licensing technological know-how to foreign companies.

The risks associated with licensing can be reduced by entering into a cross-licensing agreement with a foreign firm. Under this agreement, a firm might license some invaluable tangible property to a foreign partner, but the firm can request the foreign partner to license some of its valuable know-how to the firm, in addition to a royalty payment.

Another way of reducing risk is to link an agreement to license know-how with the formation of a joint venture in which the licensor and the licensee have equal stakes.

9.4.4 Franchising

Franchising is a specialized form of licensing in which the franchisor sells the intangible property to the franchisee and also insists the franchisee to agree to abide by strict rules of conducting a business. The franchiser also assists the franchisee to run the business on an ongoing basis. Franchising receives a royalty payment like licensing. Franchising is employed by service firms. For instance, McDonald’s uses a franchising strategy where the franchisees follow strict rules of operating a restaurant, and the control is extended to menu, cooking methods, design, location, and staffing policies.

Example

7-Eleven is a Japanese-American international chain of convenience stores. It is the world's largest convenience store chain with over 67000 stores around the world. In February 2019, the company signed a master agreement with Future Group (Indian Retail Company) to open and manage the eponymous brand stores in India. Future Retail's subsidiary SHME Food Brands will open newer stores as well as convert existing locations to the 7-Eleven brand. Ken Wakabayashi (7-Eleven Inc. International Head) said “This strategic relationship offers an excellent opportunity to bring 7-Eleven’s brand of convenience and its iconic products to the Indian consumer.” He further added, "7-Eleven will support Future Retail Ltd to implement and localize the unique 7-Eleven business model." Kishore Biyani (founder of Future Group) said, “7-Eleven, Inc. is among the most iconic global brands in the food retail landscape. We are proud to bring this globally trusted convenience store to India.”

Source: ICFAI Research Center

Advantages

The firm is relieved of costs and risks of opening a foreign market on its own. Instead, the franchisee assumes these risks and costs.

Disadvantages

Franchising inhibits the ability of a firm to take out profits earned in one country to support competitive attacks in another country. A significant disadvantage of franchising is quality control. The foundation of a franchising agreement is that the brand name of a firm conveys a message to consumers about the firm's product quality. This disadvantage can be overcome by setting up a subsidiary in each country in which the firm expands. The subsidiary can be a joint venture with a foreign company or can be wholly owned. The subsidiary assumes the rights and obligations to establish franchises throughout the particular region or country. The proximity and smaller number of franchisees to oversee reduces the challenges of quality control.

Example: McDonald's Franchising Practices

McDonald's Corporation (McDonald's) is one of the largest food service organizations in the world. It had a significant market share in the restaurant service segment in almost all the countries where it had a presence. McDonald's was considered as one of the most renowned brands in the fast food segment. Its history can be traced back to 1955 when its founder Ray A. Kroc started the first McDonald's restaurant in Des Plaines, Illinois, USA. Within a very short time, McDonald's extended its operations throughout the world. McDonald's fast expansion into international markets could be attributed to its franchisee model.

McDonald's chose franchising as the best method of doing business in international markets and was regarded as a premier franchising company around the world. In fact, 70 percent of its restaurant businesses were owned and operated by franchisees. McDonald's strongly believed that its success depended upon the success of its franchisees. Therefore, it was very particular with regard to choosing its franchisees and followed a distinct procedure in doing so.

The franchisees were selected on the basis of certain parameters like highly qualified individuals in terms of education, individual's overall business experience, past business and personal history of the individual, ability to lead the people, high interpersonal relationships and full dedication to the success of the business. The franchisee had to pay an initial fee to McDonald's at the time of opening a new restaurant. The choice of site location lay with the franchiser and it also took up the responsibility of acquiring the property and constructing the building. But the responsibility of furnishing the building lay with the franchisee. Every franchisee had to attend training programs conducted by McDonald's. However, McDonald's allowed its franchisees the freedom to manage their business and did not interfere in their day-to-day operations.

Contd….

The franchisees received support from the parent company in areas like operations, training, advertising, marketing, real estate, construction, and purchasing equipment. Thus, even after setting up its own business, the franchisee was offered support by the franchisor. Generally, the training program lasted for nine months, and was provided to the franchisees free of cost. The training started with teaching basic restaurant operations like cooking, serving, cleaning, etc. Once the trainees had gained knowledge in these, the training was then conducted at regional training centers. Here, the emphasis was on various areas such as business management, leadership skills, team building, and handling customer enquiries. In the final part of the training program, the franchisees were given coaching in controlling the stock and ordering, recruiting of people, and maintaining of accounts. In 1961, McDonald's established the Hamburger University, a world-wide management training center in Oak Brook, Illinois, USA, to train its employees and franchisees. It also set up ten international training centers in England, Japan, Germany, and Australia.

The franchisees benefited from McDonald's various activities such as national marketing, which was carried out to analyze consumer attitudes and perceptions in different respective countries. The research findings helped franchisees to predict the market for a particular product, thereby reducing their risk in the business. McDonald's gave utmost importance to quality and laid down certain standards to be followed by its franchisees all over the world. To satisfy customers, the company relied on quality service, cleanliness, and providing value for money. McDonald's also believed in customizing the menu to suit the tastes of the local customers and in constant improvisation of the menu to meet customers' changing needs.

Compiled from various sources.

9.4.5 Joint Ventures

A joint venture entails establishment of a firm that is jointly owned by two or more otherwise independent firms. For instance, Fuji Xerox set up a joint venture between Xerox and Fuji Photo. The most typical joint venture is a 50/50 venture, in which two parties hold a 50 percent ownership stake each and contribute a team of managers for sharing operating control. However, in some joint ventures, one firm has a majority stake and thus has tighter control.

Example

In February 2019, OYO, a popular India-based online hotel booking platform and hospitality company forayed into the housing rental market in Japan by entering into a contract with Yahoo Japan Corporation. Through this deal, both the companies together formed a new hospitality firm in Japan.

Contd….

Japanese entrepreneur and former Japan market leader for Handy and Booking.com, was appointed as the CEO of the newly formed company. Ritesh Agarwal (OYO Hotels and Homes CEO and founder) said, "This new entity will be focused on creating unique living experiences for the Japanese citizens, students, and young professionals, looking for good quality affordable accommodations, starting with our fully managed homes brand - OYO LIFE." Expressing similar sentiments, Yahoo Japan CEO Kentaro Kawabe said the company is really happy to partner with OYO. He further added, "With our local know-how, online distribution network and marketing support, OYO LIFE will soon emerge as the most preferred abode for the Japanese citizens and visitors in the country."

Source: ICFAI Research Center

Advantages

Joint ventures have many advantages. First, a firm benefits from the knowledge of the local partner about the competitive conditions, language, business systems, and political systems of the host country. Second, firms gain by sharing the development costs and risks associated with entering a foreign market. Third, in many countries, the political considerations make joint ventures the only possible mode of entry.

Example

When the strategic goals of the partnering companies are aligned, 'Joint Venture' is a less risky and preferred market entry option, particularly when there are some barriers to entry for foreign companies.

Joint Venture is often the preferred market entry method, especially in emerging markets. A company can take advantage of the partner's infrastructure, local knowledge and reputation. It allows for closer control of the business in comparison to licensing mode. If the main requirement of alignment of strategic goals is met, a joint venture enables the risks and costs – as well as the rewards – of the business to be shared. It is sometimes the only method of entry in some markets when there are strong barriers to entry.

Source: ICFAI Research Center

Disadvantages

There are major disadvantages with joint ventures. First, a firm entering a joint venture risks giving control of its technology to its partner. However, joint venture agreements can be constructed to minimize risks. One option is to hold majority stake in the joint venture so that the dominant partner can exercise greater control. Another option is to "wall off" from a partner technology that is central to the core competence of the firm.

A second disadvantage is that a joint venture does not give a firm tight control over its subsidiaries that it may need to realize location and experience curve economies. Nor it gives the firm control over a foreign subsidiary that it might need to engage in coordinated global attacks against its competitors.

A third disadvantage with joint ventures is that the shared ownership arrangement can lead to conflicts and battles for control between the investing firms if their objectives and goals change or if they have different views over what the strategy should be.

9.4.6 Wholly-owned Subsidiaries

In a wholly-owned subsidiary, a firm owns 100 percent of the stock. A wholly-owned subsidiary can be established in a foreign market two ways. The firm can either set up a new operation in that country, called a Greenfield venture, or it can acquire an established firm in the host nation and can use the firm for promoting it products.

Example

In September 2017, UK-based automotive marquee MG Motor inaugurated its first-ever manufacturing facility in India, through a minimum initial investment of Rs 2,000 crore. With an initial capacity of 80,000 units per annum in the first phase, MG Motor India would roll out its first product from the plant in 2019. The state-of-the-art facility, spread over an area of 170 acres. The facility would entail creation of significant number of jobs, apart from several additional indirect jobs in the state, as part of the 'Make in India' and 'Skill India' initiatives.

Source: ICFAI Research Center

Advantages

There are several advantages of wholly-owned subsidiaries. First, when the competitive advantage of a firm is based on technological competence, a wholly-owned subsidiary will often be the preferred mode of entry as it reduces the risk of losing control over that competence. Second, a wholly-owned subsidiary gives a firm tight control over operation in different countries. This is essential for engaging in global strategic coordination.

Third, a wholly-owned subsidiary may be required if a firm wants to realize experience curve and location economies. When cost pressures are intense, it may pay a firm to configure its value chain in such a way that the value added at each stage is maximized.

Disadvantages

Establishing a wholly-owned subsidiary is the costliest method of serving the foreign market from the standpoint of capital investment. Firms have to bear the full capital costs and risks of setting foreign operations.

Activity 9.1

FastFood Corp. (FastFood) is a US-based fast food chain that was rapidly growing in the US market. The company planned to increase its business by expanding globally. The company decided to enter the Indian and Chinese markets. Instead of setting up its own stores, the company entered into agreements with local fast food chains in India and China. As per the agreement, the partners had to use the same brand name as that of FastFood. The partners also had to adapt the menu, store design, and hiring policies of FastFood. Identify the type of agreement. Also discuss its advantages and disadvantages.

Answer:

9.5 Selecting an Entry Mode

Trade-offs is inevitable when an entry mode is being selected. For instance, when a firm is considering entering into an unfamiliar country with a track record of discriminating foreign-owned enterprises, a firm might favor a joint venture with a local enterprise. Its rationale might be that the local partner would help it establish operations in an unknown environment and will help the company earn contracts from the government. However, if the core competency of the firm is in proprietary technology, entering a joint venture might risk losing control of that technology to the joint venture partner. Despite such trade-offs, it is possible to make some generalizations about the optimal choice of entry mode.

9.5.1 Core Competencies and Entry Mode

Firms expand internationally to earn greater returns from their core competencies, skill transfer, and products derived from their core competencies to foreign markets where indigenous competitors lack those skills. The optimal mode of entry for such firms depends on the nature of core competency to some extent. A distinction can be drawn between firms whose core competency is in technological know-how or in management know-how.

Technological Know-how

If the competitive advantage of a firm is based on control over proprietary technological know-how, joint venture and licensing arrangements should be avoided if possible in order to minimize the risk of losing control over that technology. Thus if a high tech firm establishes its operations in a foreign country to profit from a core competency in technological know-how, it will go through a wholly owned subsidiary. However, sometimes a joint venture and licensing arrangement can be structured to reduce the risk of licenses or joint venture partner confiscating technological know-how. Another exception exists when a firm perceives its technological advantage to be transitory, when it expects imitation of its core technology by competitors. In such cases, the firm might want to license its technology rapidly so that foreign firms gain global acceptance for its technology before any imitation occurs. This strategy has some advantages. By licensing its technology to competitors, the firm may dissuade from developing its own, superior technology. Further, by licensing its technology, the firm may establish its technology as the dominant design in the industry. This ensures a steady stream of loyalty payments.

Management Know-how

The competitive advantage of many service firms depends on the management know-how. For such firms, the risk of losing control over the management skills to joint-venture partner or franchisees is not great. The valuable asset of these firms is the brand name, which are protected by international laws pertaining to trademarks. Many issues arising in the case of technological know-how are of less concern here. Thus, many service firms favor a combination of subsidiaries and franchising to control the franchisee within particular countries or regions. The subsidiaries can be wholly-owned or joint ventures. A joint venture is more acceptable politically and brings a degree of local knowledge to the subsidiary.

9.5.2 Pressures for Cost Reductions and Entry Mode

The greater the cost reduction pressures, the more likely a firm will want to pursue a combination of exporting and wholly owned subsidiaries. By manufacturing in locations where factor conditions are optimal and then exporting to the world, a firm may realize substantial experience curve and location economies. The firm might then want to export the finished product to marketing subsidiaries based in various countries. Typically, these subsidiaries will be wholly-owned and have the responsibility to oversee distribution in their particular countries. Establishing a wholly-owned marketing subsidiary is preferable than a joint venture arrangement and to use foreign marketing agents because it gives the firm tight control that could be required to coordinate a globally dispersed value chain. The firm can also use the profits it achieves in one market to improve its competitive position in another market. In other words, firms pursuing a transnational or global standardization strategy prefer setting up a wholly-owned subsidiaries.

Example

Many transnational firms prefer to have manufacturing hubs in countries like India, Vietnam and China, where factor conditions are optimal. They export to other countries from these manufacturing hubs. Through this model, a firm may benefit from the learning and experience and simultaneously gain location economies. Firms (under cost reduction pressure) desiring cost reduction may prefer such a transnational strategy.

The greater the cost reduction pressures, the more likely a firm will want to pursue a combination of exporting and wholly owned subsidiaries. By manufacturing in locations where factor conditions are optimal and then exporting to the world, a firm may realize substantial experience curve and location economies. In the above case, transnational firms facing high level of competition and cost pressures prefer the transnational strategy.

Source: ICFAI Research Center

9.6 Greenfield Venture versus Acquisition

A Greenfield venture is one where “a firm can establish a wholly-owned subsidiary in a country by building a subsidiary from the ground-up.” A multinational enterprise (MNE) can set up a wholly-owned subsidiary either through a Greenfield investment or an international acquisition. A Greenfield investment is an “initial establishment of fully-owned facilities and operations undertaken by the company alone.” An international acquisition is a “cross-border transaction in which a foreign investor acquires an established local firm and makes the acquired local firm a subsidiary business within its global portfolio.” A company can expand its investment in a target country quickly by international acquisition of a local firm or a foreign firm with other local ventures. An acquisition can be useful particularly when entering sectors which were formerly restricted only for state-owned enterprises. Moreover, cash flows can be generated in a lesser time than Greenfield ventures since the acquired company does not need to be built up from the scratch. Acquisitions deals may be more attractive than Greenfield ventures since acquisitions offer immediate access to the acquiree’s resources. Thus MNEs calculate various risks before setting up a Greenfield venture or acquiring an international company.

Example

Millennium Power Ltd., an Indian company that specializes on renewable energy is keen to expand its operations to at least two of India’s neighboring countries. The top managers of the company are concerned about the political risks that have increased in these countries during the covid pandemic. Here, Greenfield investments maximize the political risks for Millennium Power Ltd.

Contd…..

Greenfield Investments are riskier than most of the other foreign entry modes. They are more vulnerable to political risks because it is harder to divest from a wholly owned production facility. Therefore, considering the high political risk that prevails, Millennium Power can avoid Greenfield Investments and opt for less risky options like Joint Venture.

Source: ICFAI Research Center

9.6.1 Pros and Cons of Acquisitions

Acquisitions have many advantages. First, acquisitions are quick to execute. By acquiring an established enterprise, a firm can rapidly build its presence in the foreign market.

Second, firms use acquisitions to preempt their competitors. The need for preemption is great in markets that are rapidly globalizing, such as telecommunications. For instance, the US$ 60 billion acquisition of Air Touch Communications in the US by British telecom company, Vodafone.

Third, managers may believe acquisitions to be less risky than Greenfield ventures. In an acquisition, a firm buys a set of assets that are producing a known revenue and profit stream. In contrast, the revenue and profit stream generated by a Greenfield venture might generate is uncertain as it does not exist yet. Suck knowledge can reduce the mistakes caused by ignorance of national culture.

9.6.2 Reasons for Failure of Acquisitions

Acquisitions fail for a number of reasons. First, the acquiring firm overpays for the assets of the acquired firm. The price of the target firm can be bid up if many firms are interested in purchasing it. In addition, the management of the acquiring firm is usually optimistic about the value that can be created through an acquisition and is thus willing to pay a significant premium over market capitalization of the target firm. This is known as the "hubris hypothesis" of why acquisitions fail. According to this hypothesis, top managers typically overestimate their ability to create value from an acquisition, chiefly because rising to the top of a corporation has given them an overstated sense of their own abilities.

Second, many acquisitions fail due to cultural clashes between the acquired and the acquiring firm. Many companies also experience employee turnovers as the employees do not fit into the culture of the acquiring firm. The loss of expertise and management talent can harm the performance of the acquired unit. This may be problematic in international business, where management of the acquired firm has valuable local knowledge that is difficult to replace.

Example

Microsoft4 paid a huge $7.5 billion to acquire GiftHub Inc, which is a provider of internet hosting for software development. With its collaborative features, GiftHub is the best place for individuals and teams to write and code faster. Microsoft would be installing a new CEO for GiftHub and its approach to integration of the newly acquired company would be similar to that of LinkedIn's integration, where greater independence was given. Post-acquisition, GiftHub would maintain its developer-first-ethos and operate independently to provide an open platform to all developers in the industry.

Microsoft, the acquiring company has insisted that GiftHub retain its open-source ethos and developer-first culture. This broad outlook towards integration of the acquired company would ensure that cultural clashes are less likely.

Source: ICFAI Research Center

Third, many acquisitions fail as attempts to realize synergies by integrating the operations of the acquiring and the acquired entities often run into roadblocks. The slow integration of operations is attributed to differences in management philosophy and company culture. These problems can be exacerbated by differences in national culture. The process can also get complicated due to bureaucratic haggling.

Finally, inadequate pre-acquisition screening also results in failure of many acquisitions. Many firms decide to acquire other firms without making a thorough analysis of the potential benefits and costs.

9.6.3 Reducing the Risks of Failure

These problems can be overcome if the firm is careful about its acquisition strategy. The foreign enterprise to be acquired should be screened including a detailed auditing of financial position, operations, and management culture. This helps ensure that the firm does not pay too much for the acquired firm, does not uncover any nasty surprises post acquisition, and acquires a firm whose organizational culture is not opposite to that of the acquiring company. It is also important for the acquiring firm to alleviate any concerns the management of the acquired enterprise would have. The objective should be to reduce unwanted attrition in management after the acquisition. Finally, after the acquisition, the management should rapidly put an integration plan into place and should act on the plan.

[4] https://techcrunch.com/2018/06/04/microsoft-has-acquired-github-for-7-5b-in-microsoft-stock/

9.6.4 Pros and Cons of Greenfield Ventures

The biggest advantage of setting up a Greenfield venture in a foreign country is that it gives the firm a greater ability to build the kind of subsidiary company that it desires. For instance, it is easier to build the organizational culture from scratch than it is to change the organizational culture of the acquired unit. Similarly, it is much easier to establish a set of operating routines in a new subsidiary than it is to convert the operating routines of the acquired firm. This is a very crucial advantage for many international businesses where transferring competencies, products, skills, and know-how from the firm's established operations to the new subsidiary are principal ways for creating value.

Despite several advantages, there are several disadvantages of a Greenfield venture. They are slower to establish and are risky. A degree of uncertainty is also associated with future revenue and profit prospects. A final disadvantage is the possibility of being preempted by aggressive global competitors who enter through acquisitions and build a market presence that limits the market potential of the Greenfield venture.

9.6.5 Greenfield Venture or Acquisition?

It is not easy to make a choice between acquisitions or Greenfield ventures. Both have their advantages and disadvantages. In general, the choice depends on the circumstances confronting the firm. If a firm wishes to enter a market where there are already-established enterprises, and where global competitors are also interested in establishing their presence, an acquisition route is a viable option. If a firm wishes to enter a country where there are no incumbent competitors for acquisition, the Greenfield venture may be the only mode. Even if incumbents exist, a Greenfield venture is still preferable if the firm's competitive advantage is based on the transfer of organizationally embedded skills, routines, competencies, and culture.

9.7 Strategic Alliances

Strategic alliances refer to "cooperative agreements between potential or actual competitors." Strategic alliances range from formal joint ventures in which two or more firms have equity stakes, to short-term contractual agreements in which two companies agree to cooperate on a particular task.

9.7.1 Advantages of Strategic Alliances

One of the biggest advantages of a strategic alliance is that facilitate entry into foreign markets. For instance, if a firm is considering a successful entry into the Chinese market, it needs a local partner who understands business conditions and has good connections in China.

Second, strategic alliances allow firms to share the fixed costs of developing new products or processes. For instance, an alliance between Boeing and a number of Japanese companies to build the commercial jetliner, the 7E7, was motivated by

Boeing's desire to share the estimated US$ 8 billion investment required for developing the aircraft.

Third, an alliance brings together complementary skills and assets that neither company could develop easily on its own.

Fourth, it makes sense to form an alliance that helps the firm establish technological standards for the industry that would benefit the firms.

9.7.2 Disadvantages of Strategic Alliances

Some commentators have criticized strategic alliances saying that competitors get access to a low-cost route to new markets and technology. The critics also point out that alliances have risks. A firm may give its partner more than it receives in an alliance.

9.7.3 Making Alliances Work

The success of strategic alliance depends on three main factors – partner selection, alliance structure, and managing the alliance.

Partner Selection

The key to managing a strategic alliance is to select the right partner. A good partner has three characteristics. First, a good partner helps the firm in achieving its strategic goals, whether it includes, sharing of costs and risks associated with product development, market access, or accessing critical core competencies. The partners should have the capabilities lacked by the firm. Second, a good partner shares the vision of the firm for the purpose of alliance. If the two firms entering an alliance do not share the same vision the relationship will not be harmonious and will not flourish. Third, a good partner does not exploit the firm opportunistically, that is, it does not expropriate the technological know-how of the firm while giving away little in return.

To select a partner with these characteristics, a firm needs to conduct comprehensive research on potential alliance partners. Thus a firm should collect publicly available information on potential partners, gather data from third parties, and get to know the potential partner prior to committing to an alliance.

Alliance Structure

Having selected a partner, an alliance should be structured so that the risk associated with a firm giving too much to its partner is reduced to an acceptable level. First, alliances can be made difficult to transfer technology that should not be transferred. The design, development, manufacture, and service of a product created by an alliance can be structured to separate sensitive technologies for preventing their leakage to the other participant. For instance, in an alliance between General Electric and Snecma for building commercial aircraft engines, GE reduced the risk of transferring in excess by walling off certain sections of the production process.

Second, contractual safeguards can be written into an agreement of the alliance to guard against the risk of opportunism by a partner.

Third, parties in an alliance can agree in advance for swapping skills and technologies to ensure that both have an equitable gain. This goal can be achieved through cross-licensing agreements.

Fourth, the risk of opportunism can be reduced if the firm extracts in advance significant commitment from its partner.

Managing the Alliance

Once a partner is selected and an alliance structure has been agreed on, the task facing the firm is to maximize its benefits from the alliance. In all international business deals, an important factor is sensitivity to cultural differences. Most of the differences in management styles are attributed to cultural differences, and managers need to make allowances for these in dealing with their partner. Beyond this, maximizing the benefits from an alliance involves building trust between partners and learning from them.

Successfully management of an alliance requires building interpersonal relationships between the managers of the firm, or what is referred to as relational capital. For instance, Ford and Mazda set up a framework of meetings within which managers discussed the matters pertaining to alliance and also had time to get to know each other better. The belief is that resulting friendships help in building trust and facilitating harmonious relations between the alliance partners. Personal relationships also foster an informal management network between the firms. This network can be used in solving problems arising in formal contexts.

Academics have argued that a major determinant of how much acquiring knowledge a company gains from an alliance is its ability to earn from its partner.

Firms can maximize benefits from an alliance by trying to learn from its partner and then by applying knowledge within its own organization. It is suggested that the operating employees should be briefed on the strengths and weaknesses of the partners and should understand how acquiring particular skills will bolster the competitive position of the firm.

Check Your Progress - 1

1. A firm has to contemplate three basic decisions for foreign expansion. These include

   i. Which markets to enter

   ii. When to enter those markets

   iii. Scale of entry

   iv. Market size

   v. All of the above

a. i, ii, and iv
b. v
c. ii, iii, and iv
d. i, ii, and iii

2. The advantages associated with entering a market early are called as____.
   a. First-mover advantages
   b. First-mover disadvantages
   c. Early advantages
   d. Late entrant advantages
3. In a/an ____, the contractor handles every project detail for a foreign client, including training of operating personnel.
   a. Exporting
   b. Licensing
   c. Turnkey projects
   d. Franchising
4. A _ is an arrangement wherein a licensor grants the rights to intangible property to a licensee or another entity for some specific period, and in return, the licensor receives a royalty fee from the licensee.
   a. Franchising
   b. Joint venture
   c. Wholly owned subsidiary
   d. Licensing
5. __________is a specialized form of licensing in which the franchisor sells the intangible property to the franchisee and also insists the franchisee to agree to abide by strict rules of conducting a business.
   a. Franchising
   b. Strategic alliance
   c. Acquisition
   d. Joint venture
6. A _ entails establishment of a firm that is jointly owned by two or more otherwise independent firms.
   a. Exporting joint
   b. Venture greenfield
   c. Venture
   d. Franchising

7. In which mode of entry, a firm owns 100 percent of the stock?
    a. Franchising
    b. Joint venture
    c. Wholly-owned subsidiary
    d. Strategic alliances
8. A _ is one where a firm can establish a wholly-owned subsidiary in a country by building a subsidiary from the ground-up.
    a. Joint venture
    b. Greenfield venture
    c. Franchising
    d. Strategic alliances
9. A/An _____ is a cross-border transaction in which a foreign investor acquires an established local firm and makes the acquired local firm a subsidiary business within its global portfolio.
    a. Joint venture
    b. Greenfield investment
    c. International acquisition
    d. None of the above
10. ___refer to cooperative agreements between potential or actual competitors.
    a. Licensing
    b. Exporting
    c. Franchising
    d. Strategic alliances

9.8 Summary

- A firm has to contemplate three basic decisions for foreign expansion – which markets to enter, when to enter those markets, and on what scale.
- Firms can use various entry modes such as exporting, turnkey project, licensing, franchising, establishing joint ventures with a host firm, or setting up a wholly-owned subsidiary in the host country.
- Firms expand internationally to earn greater returns from their core competencies, skill transfer, and products derived from their core competencies to foreign markets where indigenous competitors lack those skills.
- A Greenfield venture is one where a firm can establish a wholly-owned subsidiary in a country by building a subsidiary from the ground-up.
- Strategic alliances refer to cooperative agreements between potential or actual competitors.

9.9 Glossary

Franchising: Franchising is a specialized form of licensing in which the franchisor sells the intangible property to the franchisee and also insists the franchisee to agree to abide by strict rules of conducting a business.

Greenfield venture: A Greenfield venture is one where a firm can establish a wholly-owned subsidiary in a country by building a subsidiary from the ground-up.

International acquisition: An international acquisition is a cross-border transaction in which a foreign investor acquires an established local firm and makes the acquired local firm a subsidiary business within its global portfolio.

Licensing: A licensing agreement is an arrangement wherein a licensor grants the rights to intangible property to a licensee or another entity for some specific period, and in return, the licensor receives a royalty fee from the licensee.

Strategic alliances: Strategic alliances refer to cooperative agreements between potential or actual competitors.

9.10 Self-Assessment Test

1. A firm has to contemplate three basic decisions for foreign expansion. State and describe those decisions in detail.
2. Briefly describe modes of entry a firm can consider while entering a foreign market.
3. Discuss how a firm expanding globally selects an entry mode.
4. Define a greenfield venture. Explain the advantages and disadvantages of acquisitions and Greenfield ventures.
5. Define a strategic alliance. Explain the advantages and disadvantages of strategic alliances, and how to make the alliances work.

9.11 Suggested Readings/Reference Material

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9.12 Answers to Check Your Progress Questions

1. (d) i, ii, and iii

A firm has to contemplate three basic decisions for foreign expansion – which markets to enter, when to enter those markets, and on what scale.

2. (c) International monetary system

The advantages associated with entering a market early are called as first-mover advantages.

3. (c) Turnkey project

In a turnkey project, the contractor handles every project detail for a foreign client, including training of operating personnel.

4. (d) Licensing

A licensing agreement is an arrangement wherein a licensor grants the rights to intangible property to a licensee or another entity for some specific period, and in return, the licensor receives a royalty fee from the licensee.

5. (a) Franchising

Franchising is a specialized form of licensing in which the franchisor sells the intangible property to the franchisee and also insists the franchisee to agree to abide by strict rules of conducting a business.

6. (b) Joint venture

A joint venture entails establishment of a firm that is jointly owned by two or more otherwise independent firms.

7. (c) Wholly-owned subsidiary

In a wholly-owned subsidiary, a firm owns 100 percent of the stock.

8. (b) Greenfield venture

A Greenfield venture is one where a firm can establish a wholly-owned subsidiary in a country by building a subsidiary from the ground-up.

9. (c) International acquisition

An international acquisition is a cross-border transaction in which a foreign investor acquires an established local firm and makes the acquired local firm a subsidiary business within its global portfolio.

10. (d) Strategic alliances

Strategic alliances refer to cooperative agreements between potential or actual competitors.

International Business

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