Managing the Global Firm
International Strategy Structure

Professor Mauro Guillén
Why Do Firms Go Abroad?

Growth
• In which countries isn’t Facebook #1?

Efficiency
• “Designed by Apple in California. Assembled in China.”

Learning
• Bimbo in China: Sales and ideas.
Value Chain Analysis

R&D

Inputs

Production

Sales

Service

Foxconn

R&D

Inputs

Production

Sales

Service

Apple

R&D

Inputs

Production

Sales

Service

Samsung
An Important Qualification

- **Product**: Both tangible goods and intangible services
- **Production**: The activities required to bring to reality a good or a service
- **Distribution and Sales**: The activities required to bring the good or service to the customer
Vertical Internationalization

- Backward along the value chain to obtain some input
- Forward into the market
Horizontal Internationalization

• The firm replicates the value chain in each country:

Country A
- R&D
- Inputs
- Production
- Sales
- Service

Country B
- R&D
- Inputs
- Production
- Sales
- Service

Country C
- R&D
- Inputs
- Production
- Sales
- Service
Key Concept: Integration

• Should the firm undertake all of the activities along the value chain?
• Which activities should other firms (i.e. suppliers) carry out?
• If the firm performs an activity, it is integrating it within its boundaries
  • Integrated activity
Backward Vertical Integration

• A given input will be sourced from another country if there is a comparative cost advantage (adjusted for quality)

• The input will be integrated when:
  • The transaction costs of dealing with a supplier are prohibitive
  • There is too much uncertainty or unpredictability
Forward Vertical Integration

• Sales and service activities take place in another country when it is important to have a commercial presence on the ground

• These activities are integrated when:
  • The transaction costs of dealing with an agent or distributor are prohibitive
  • There is too much uncertainty
Outsourcing & Offshoring

- Sales and service activities can also be located in a low-cost country following the logic of backward vertical integration
  - Especially frequent for labor-intensive back office operations
  - Also used for core service operations
R&D Strategies of MNEs: More than doing R&D in Multiple Countries

On the one hand, R&D activities are concentrated in technology clusters, with close interactions among direct competitors.

On the other hand, MNEs are spreading their R&D activities across dispersed locations.

Local competition and institutional environment (e.g., the strength of IP protection) affects how MNEs organize their R&D network globally...

...in the forms of cross-border collaborations or interdependence of specialized knowledge.

Such strategic organization of global R&D, in turn, affects the dynamics in the local clusters.

Horizontal Expansion

• The firm replicates its value chain in each national market in the presence of:
  • High transportation costs
  • Protectionism
  • Currency exchange rate fluctuations
  • Need to adapt the product to local peculiarities

• Alternatives: Licensing or franchising

• The firm will prefer to undertake horizontal expansion by itself in order to protect its:
  • Brands
  • Technology
  • Know-how
Comparative Advantage: Absolute and Relative

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<th>Labor costs:</th>
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</table>
Hybrid Expansion

Activities are located selectively

Country A
- R&D
  - Inputs
  - Production
  - Sales
  - Service

Country B
- R&D
  - Inputs
  - Production
  - Sales
  - Service

Country C
- R&D
  - Inputs
  - Production
  - Sales
  - Service
Managing the Global Firm
Exporting and Investing

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Exporting

• It’s the simplest international strategy
• It may or may not be the optimal strategy, depending on
  • Production costs
  • Barriers to entry into foreign markets
  • Image considerations
Types of Exporting Strategies

• Without forward vertical integration:
  • Relies on a distributor or agent

• With forward vertical integration:
  • Requires investment in storage, distribution, sales, and after-sales service
Foreign Investment

- Foreign direct investment, as opposed to foreign portfolio investment
- In search of:
  - Markets
  - Efficiency
  - Strategic assets
  - Natural resources
- Modalities:
  - Greenfield- Stating from scratch
  - Acquisitions- Using an existing company
In Search of Markets

• It can be either:
  • Vertical, with investments, with investments in storage, distribution, sales or service
  • Horizontal, with investments that combine production and sales in a foreign market
In Search of Efficiency

• Amounts to backward vertical integration aimed at reducing production costs in another location
• The alternative is to use a supplier
  • It makes sense when transaction costs or uncertainty are high
In Search of Strategic Assets

• The firm is interested in owning a brand, technology or other intangible asset
• The alternative would be to pay a royalty for the use of the asset
In Search of Natural Resources

- Very common in energy, oil and mining
- The alternative is to contract with a supplier
  - It makes sense when transaction costs or uncertainty are high
- In the case of oil companies, their market valuation depends on the amount of proven reserves
### Four International Strategies

<table>
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<th>Extent of Coordination:</th>
<th>Number of countries in which the firm invests:</th>
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<tr>
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Types of Acquisitions

• Vertical
  • They allow the firm to gain access to a source of supply or to the market

• Horizontal
  • They allow the firm to grow in market share

• Strategic
  • They allow the firm to access a resource or capability that is not possible or efficient to develop internally
Oligopolies and Acquisitions

• Acquisitions in general, and foreign acquisitions in particular, are more common in oligopolistic industries

• Oligopoly: a competitive structure with just a handful of firms due to first-mover advantages, economies of scale, or barriers to entry
Managing the Global Firm

The Role of Cross-National Distance

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Entry Mode into Foreign Markets

• It’s always a strategic choice
• There are many internal and external factors that affect the choice
• The firm may enter foreign markets by itself or in collaboration with others
Distance as Metaphor

• Distance is a metaphor that indicates how difficult it is to enter a specific market.
• It is normally measured from the home market of the firm, or from the set of markets in which it already operates.
  • A more distant country is more difficult to enter and to operate in than a less distant country.
Implications of Distance

1. Sequence of countries to enter
   • Better for firm to enter countries that are less distant
2. Entry mode choice
3. Type of products and services offered in each market
Definitions of Distance

- Geographic
- Economic- Purchasing power
- Demographic- Age structure
- Political- Political risk
- Cultural- Values and norms
- Administrative- Regulatory intensity
- Linguistic- Writing systems
- Legal- Legal systems
Social networks matter!

If there are immigrants in a foreign location, companies from the same country as the immigrants are
• More likely to invest in that location
• More likely to stay in business in that location
• More profitable in that location

Why? Immigrants can help companies:
1. Learn about business opportunities
2. Find customers and increase sales
3. Lower costs

But this only helps companies of the same nationality as the immigrants, not all foreign companies

Managing the Global Firm

Case Comparison: H&M, Zara & Uniqlo

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H&M Stores

1947: Sweden
1964: Norway
1967: Denmark
1976: UK
1978: Switzerland
1980: Germany
1989: Holland
1992: Belgium
1994: Austria
1996: Luxembourg
1997: Finland

1998: France
2000: USA, Spain
2003: Poland, Czech Republic, Portugal, Italy
2004: Canada, Slovenia
2005: Ireland, Hungary
2006: Dubai, Qatar
2007: Hong Kong, China, Slovakia, Qatar
2008: Japan, Bahrain, Egypt, Israel, Jordan, Kuwait, Oman, Morocco, Saudi Arabia
2009: S Korea, Russia, Lebanon
2010: Israel, Turkey
2011: Singapore, Croatia, Romania
2012: Thailand, Malaysia, Bulgaria, Latvia
2013: Indonesia, Estonia, Lithuania, Chile
2014: Australia, Philippines
2015: Taiwan, Peru, Macau, South Africa, India
2016: Puerto Rico, Cyprus, New Zealand
2017: Planned in Colombia, Kazakhstan, Iceland, Georgia, Vietnam
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“A fashion is merely a form of ugliness so absolutely unbearable that we have to alter it every six months!”

— Oscar Wilde
Features of Entry Modes

• Control
• Commitment
  • Customers
  • Suppliers
  • Regulators
  • Competitors
Typology of Entry Modes

- Commitment →
- Control ↑

- Licensing
- Exports
- Joint Ventures
- Franchising

- Exports with proprietary distribution
- 100% Ownership
Example: Iberdrola

- World’s largest operator of green power farms
- 1992: Wins bid to run a thermal plant in Argentina
- 1994: Acquires Scottish Power in the UK
- 2000: Sells technology services to the National Office of Electricity in Morocco
- 2010: Builds two photovoltaic plants in the U.S.
- 2014: Iberdrola and Siemens sign a strategic alliance for the development of smart grids in the Middle East
100%-Owned Subsidiaries

• They can be either greenfield or full acquisitions
• Subsidiaries:
  • Sales
  • Production of an input or component
  • Production of the final good or service
  • R&D
Greenfield vs. Acquisition

Is it feasible to buy the desired assets in the market?

Yes → Greenfield investment

No → Is it feasible to acquire existing companies?

Yes → Full or partial acquisition

No → Joint venture

Factors to Consider

- Entry modes that do not surrender any control are normally used when the firm possesses the resources and capabilities to establish operations by itself.
- Control is also necessary when the firm has valuable brands, technology or know-how.
What are Collaborative Alliances?

Agreements that enable the firm to access non-tradeable resources controlled by another firm, but without merging with it

Examples:
- Long-term contracts without equity investments
- Cross-shareholdings
- Joint ventures
- Consortia
Typology of Collaborations

Contractual

- Traditional: Buy-sell agreements, Franchising, Licensing
- Non traditional: Long-term contract

With equity participation

- Without a new entity: Minority investment, Cross-shareholdings
- With new entity: Joint venture
- Mergers and acquisitions

Strategic Alliances
Alliance Goals

• Access a new market
• Access technology or know-how
• Share costs or risks
• Reach economies of scale
• Bid for a concession or contract
• Increase bargaining power
  • Suppliers
  • Customers
  • Regulators
• Collaborate when a merger is not possible
• Move faster
Dimensions

- Task complexity- How difficult it is to attain the goals of the alliance
- Organizational complexity- How will decisions be made?
- Partner selection

Task Complexity (TC)

- (+) Number of goals
- (+) Duration
- (+) Number of markets
- (+) Number of products / services
- (+) Uncertainty

Organizational Complexity (OC)

• (+) Number of partners
• (-) Routinization of interactions
• (+) Frequency of interaction
• (-) Trust among partners

Key Concept: Alliance Decision-Making Modes

- Separate control
- Dominant control
- Shared control

Separate Control

- OC < TC
- High trust level reduces OC
- Hard to implement if:
  - Number of products/services is large
  - Number of markets is large
  - Interactions are not routine
  - Interactions are frequent

Dominant Control

- OC < TC
- Difficult if:
  - No partner predominates
  - All partners have something to contribute
  - Goals are not aligned

Shared Control

- Danger that OC > TC
- Yet, it is the most common mode
- Difficult if:
  - Trust among partners is low

What to Do?

One reduces OC by:

• Increasing trust
• Letting one partner be dominant

Airline Alliances

• Goals: cost reductions, capacity optimization, and customer experience
• Three global alliances: OneWorld, Star, SkyTeam
• History of these alliances is replete with frictions and other problems
• Airlines that prefer less complex and less ambitious arrangements: Emirates, Virgin Atlantic, Virgin America, Virgin Australia

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Factors in Entry Mode Choice

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Key Factors

- Host country
- Home country
- The firm itself
Host Country

• Market growth potential
• Competitive structure
• Quality of the infrastructure
• Barriers to entry
• Cultural or social peculiarities
• Political risk
<table>
<thead>
<tr>
<th>Transactional Risk:</th>
<th>Political Risk:</th>
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|                   | LOW            | HIGH  
| HIGH             | Collaboration with a local partner is neither necessary nor advisable | Collaboration with a local partner is helpful but has disadvantages  
| LOW              | Collaboration with a local partner is not necessary | Collaboration with a local partner is optimal  

Home Country

- Production costs
- Competitive structure
The Firm Itself

- Size
- Resources
- Intangible assets:
  - Brands
  - Technology
  - Know-how
- Risk aversion
- Goals
Example: Häagen-Dazs

- Founded in 1961- first shop in 1976
- They don’t sell ice cream, they sell indulgence
- Foreign market entries:
  - 1982- Canada, using licensing
  - 1983- HK and Singapore, using licensing
  - 1984- Japan, 50/50 joint venture with Suntory
  - 1987-1990- Failed entry into Europe
  - 1992- Wholly-owned plant in France
  - JVs for South Korea, Thailand, and the Philippines
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Entry Mode Sequence

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International Growth

- Domestic market
- Occasional exports
- Systematic exports
- Alliances in distribution
- Proprietary distribution
- International production
- International R&D
- Global coordination of operations
Alternative Models

Sales

Time

S-curve

C-curve
## Key Dimensions

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<td>Willingness to buy</td>
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<td>Competitive lead time</td>
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The S-Curve Model

• Products go through a “life cycle”:
  • Introduction
  • Growth
  • Maturation
  • Decline

• Entrepreneurs and managers:
  • Introduce new products when they see a market opportunity
  • Tend to be “myopic” or “rationally bounded”: opportunities are seen in the home market
  • Examples: consumer electronics, automobiles, wristwatches, life insurance, fast food, etc.
Stages of the S-Curve

Introduction & Growth:
- Unstandardized product
- Hard to determine optimal location, scale or price
- Many differences across producers
- Individual firms do not differentiate
- Low price-elasticity of demand

Maturation & Decline:
- Standardization
- Less uncertainty as to optimal location, scale or price
- Normalization of designs, inputs, and processes
- Individual firms differentiate through brands & features
- Increased price-elasticity of demand
Implications of the S-Curve

• The firm expands internationally following a blueprint developed in the home country
• International expansion ought to be a careful, cautious, incremental, one-step-at-a-time process
• Sequential approach:
  • Countries: “closest” first
  • Entry mode: less commitment first
  • Products: most mature first
Exceptions to S-Curve Dynamics

- Strong first-mover advantages:
  - Installed base (e.g. elevators, medical systems)
  - Prime locations (e.g. retail)
  - Tipping points (e.g. VCR systems)
  - Two-sided networks (e.g. technological platforms)
  - Customer loyalty (e.g. airlines)
  - Customer switching costs (e.g. retail banking)

- Fast-changing technologies
- Concentrated industries
H&M versus Zara

• Why did H&M expand internationally more slowly than Zara?
• Why didn’t Zara follow a systematic sequence?
Strategy and Organization

• The firm may pursue different strategies and establish itself in various ways in international markets
• Each strategy and entry mode has implications for the organization of the firm