**10(b): International Strategy**

Why companies expand into foreign markets?

Merits

1. Home market has become too small and may reach the point of saturation. The companies have to look for new markets in other countries.
2. Foreign markets provide the opportunities for the companies to reach economies of scale and therefore improve on their cost of each unit of the product. This improves the companies’ competitiveness.
3. Companies may be able to make good use of their valuable competencies and capabilities in foreign countries beside their home grounds and these may put them in a competitive position in foreign countries.

 E.g. Nokia and its mobile phones.

 4. By establishing businesses in many countries, a company may reduce its risk of

 failure. If the economies of one country were to collapse, the company can still be

 sustained by successful sales in other countries.

Risks associated with international expansion (looking at PESTEL):

1. Political and economic risk – social unrest, military turmoil, demonstrations and even violent conflict and terrorism pose serious threats to business.
2. The laws associated with the protection of intellectual property can be a significant potential risk in entering new countries e.g. piracy problems.
3. Currency risks – currency fluctuations can pose substantial risks. Sometimes a small change in the exchange rate can result in a significant difference in the cost of production or net profit when doing business overseas.
4. Management risks – differences in culture, customs, language, income levels, customer preferences, distribution system and so on can create so much risks to the foreign managers.

Limitation of PESTEL analysis

Problem with PESTEL factors is of limited value as they merely gave a list of influences. It is more useful to look at the key drivers of change because they are forces that affect the structure of the industry, sector or market. Yip’s diagram provides a good example of the key drivers that bring about the globalization of industries and markets.

Yip’s diagram

 Market globalization

 - similar customer needs

 - global customers

 - transferable marketing

 Globalization of Global globalization

 government policies - scale economies

 - trade policies Global - sourcing efficiencies

 - technical standards strategies - country-specific costs

 - host government policies - high product

 development costs

 Globalization of Competition

 - interdependence

 - competition global

 - high exports/imports

The diagram shows how key drivers of change can be identified and understood. The specific drivers vary by industry or sector. E.g. a retailer may be concerned with local customer tastes and behavior or a computer manufacturer is concerned with developments in the technological environment that lead to product innovation and obsolescence or an aging population may be a key driver or changes in public policy may affect public funding.

*What factors determine a country’s competitiveness in a particular industry?*

Michael Porter of Harvard University identified 4 broads attributes of nations that individually and as a system, constitute what is termed “the diamond of national

advantages”.

These 4 broad attributes jointly determine the playing field that each nation establishes

and operates for its industries.

The 4 factors are:

1. Factor Conditions – such as factors of production, skilled human resources, talent, transportation and communication systems, banking systems and natural resources.

Therefore the rare, valuable and difficult to imitate specific knowledge and skills of firms in a country can lead to a nation’s competitive advantage.

E.g. Japan – an island nation has little landmass, thereby making warehouse space needed to store inventory a very expensive affair. Japanese companies overcome this situation by introducing the just-in-time inventory management and gain advantage over companies in other nations that spent large sums to warehouse inventory.

2. Demand Conditions – refer to the demands that consume place on an industry for goods and services. Consumers who demand highly specific, sophisticated products and services force firms to create innovative, advanced products and services to meet the demand. The demanding consumers therefore push firms to move ahead of companies in other countries where consumers are less demanding and more complacent.

Thus the conditions of consumer demand influence a nation’s industries to better anticipate future global demand conditions and proactively respond to product and service requirements before competing nations are even aware of the need for such products and services.

E.g. Consumers in Denmark demand for environmentally safe products and it spurred Danish manufacturers to become leaders in water pollution control equipment – products

it successfully exports to other countries

3. Related and Supporting Industries – these help firms to manage their inputs for

 effectively.

 A competitive supplier helps a firm to obtain inputs using cost-effective, timely methods, thus reducing manufacturing costs. Firms working closely with suppliers provide the potential to develop competitive advantages through joint research and development and the ongoing exchange of knowledge, helping both suppliers and manufacturers.

E.g. in Italy, shoe manufacturers are geographically located near their suppliers. The manufacturers interact with leather suppliers and learn about new textures, colours and manufacturing techniques while a shoe still in the prototype stage. The manufacturers are able to project future demand and gear their factories for new products long before companies in other countries become aware of the new styles.

4. Firm Strategy, Structure and Rivalry

Rivalry is particularly intense in nations with conditions of strong consumer demand, strong supplier bases and high new entrant potential from related industries. This competitive rivalry in turn increases the efficiency with which firms develop, market and distribute products and services within the home country. Domestic rivalry, thus provides a strong impetus for firms to innovate and find new sources of competitive advantage.

This intense rivalry forces firms to look outside their national boundaries for new markets, setting up the conditions necessary for global competitiveness. Among all the points on Porter’s diamond of national advantage, domestic rivalry is perhaps the strongest indicator of global competitive success.

Firms that have experienced intense domestic competition are more likely to have designed strategies and structures that allow them to successfully compete in world markets.

Concluding comment of Factors affecting a nation’s competitiveness:

Firms that succeeded in global markets had first succeeded in intense competition in their home markets. One can conclude that competitive advantage for global firms typically grows out of relentless, continuing improvement, innovation and change.

 Domestic Rivalry

 Factor Domestic

 Conditions Demand

 Conditions

 Related &

 Supporting

 Industries

 **Porter’s Diamond**

*How firms attain competitive advantage when they move beyond the boundaries of their home nation?*

Firms face two opposing forces when they expand into global markets:

1. Cost reduction and
2. Adaptation to local markets.

These two opposing forces result in 3 different basic strategies that companies can use to compete in the global market place:

1. Global Strategy;
2. Multidomestic Strategy and
3. Transnational Strategy.

(Note: these are 3 corporate level strategies.)

 High Global Transnational

 Strategy Strategy

Pressure

to lower

Costs International Multidomestic

 Strategy Strategy

 Low

 Low High

 Pressure for local adaptation

Global Strategy:

* Most appropriate when there are strong pressures for reducing costs and comparatively weak pressure for adaptation to local markets.
* Primary emphasis is on controlling costs.
* Offers standardised products and services as well as locates manufacturing, R & D and marketing activities on only a few locations.

Advantages:

* Large volumes of production become possible.
* Economies of scale can be reached.
* Any innovation from one business unit can be transferred to other locations.
* Create a standard level of quality throughout the world.

Multidomestic Strategy:

* Most suitable where there is strong pressure for adaptation to local markets but weak pressure for reducing costs.
* Must differentiate product and service offerings to adapt to local markets.
* Decision making is decentralised to enable the firm to tailor its market needs and to charge higher prices for differentiated products and services.
* Differences in language, culture, income levels, customer preferences and distribution systems are some of the factors that can influence the kind of products and services to be provided and to be packaged.

Transnational Strategy:

* Most useful when there is a strong pressure to lower cost and for adaptation to local markets.
* Products and services of a firm must be differentiated to adapt to local markets.
* Optimise the tradeoff associated with efficiency, local adaptation and learning.
* Efficiency is necessary for global competitiveness.
* Responsiveness to local markets is flexibility necessary for international operations.
* Innovations are the outcomes of organizational learning about the needs of local markets.
* Firm’s assets and capabilities are dispersed according to the most beneficial location for a specific activity.
* Avoid concentrating activities in a central location (as in global strategy) or disperse them across many locations to enhance adaptation (as in multidomestic strategy).

The central philosophy of transnational strategy is enhanced adaptation to all competitive situations as well as flexibility by capitalizing on communication and knowledge flows throughout the organisation.

Its main characteristic is the integration of unique contributions of all units into worldwide operations. E.g. innovation is jointly done by the headquarters and one of the overseas units to develop standardised and yet flexible products and services that are suitable for multiple markets.

Note: International Strategy is a business level strategy.

* Companies sell global products and use similar marketing techniques worldwide.
* Adaptation to local customs and culture, if any is limited to minor adjustments in

 product offerings and marketing strategies.

* Do not locate their value-chain activities anywhere in the world. Examples: Boeing, McDonald’s, IBM, Kellogg, Procter & Gamble, Wal-Mart and Microsoft.
* International strategy does not work when there is a strong pressure for local adaptation or a strong pressure to reduce cost. E.g. IKEA, a Swish retailer, has traditionally pursued an international strategy, transferring its retailing formula developed in Sweden wholesale into other markets. This strategy did not work once IKEA opened its store in the US. Pressure for local responsiveness and cost reductions in the US, IKEA then shifted its strategy to accommodate local differences in tastes and preferences.

**When going international, firms go through four stages of development:**

1. Domestic stage - focus on domestic operation and market but only begin to export products and services through an export department or a foreign joint venture.
2. International stage – export products and services to foreign countries becomes important to the firms. The firm has an international division to handle sales, services and warehousing in the foreign markets and marketing programmes are custom-tailored to suit local needs of each country.
3. Multinational stage – the firm has marketing and production facilities throughout the world.
4. Global stage – the firm operates in many countries. E.g. Philips N.V., Unilever and Matsushita Electric operate in as many as 40 countries or more.

**Entry Modes of International Expansion:**

Starting with exporting, then move on to licensing, franchising, strategic alliance, joint

venture and finally wholly owned subsidiary.

Assignment

1. What motivation and risk associated with international expansion?
2. What explains the level of success of a given industry in a given country?
3. How firms can attain competitive advantages in the global marketplace?
4. What are the 4 entry strategies firms may choose to enter foreign markets?
5. What are the modes of entry firms can use to expand into international markets?