



# Chapter 13

## **The Strategy of International Business**

# What Is Strategy?

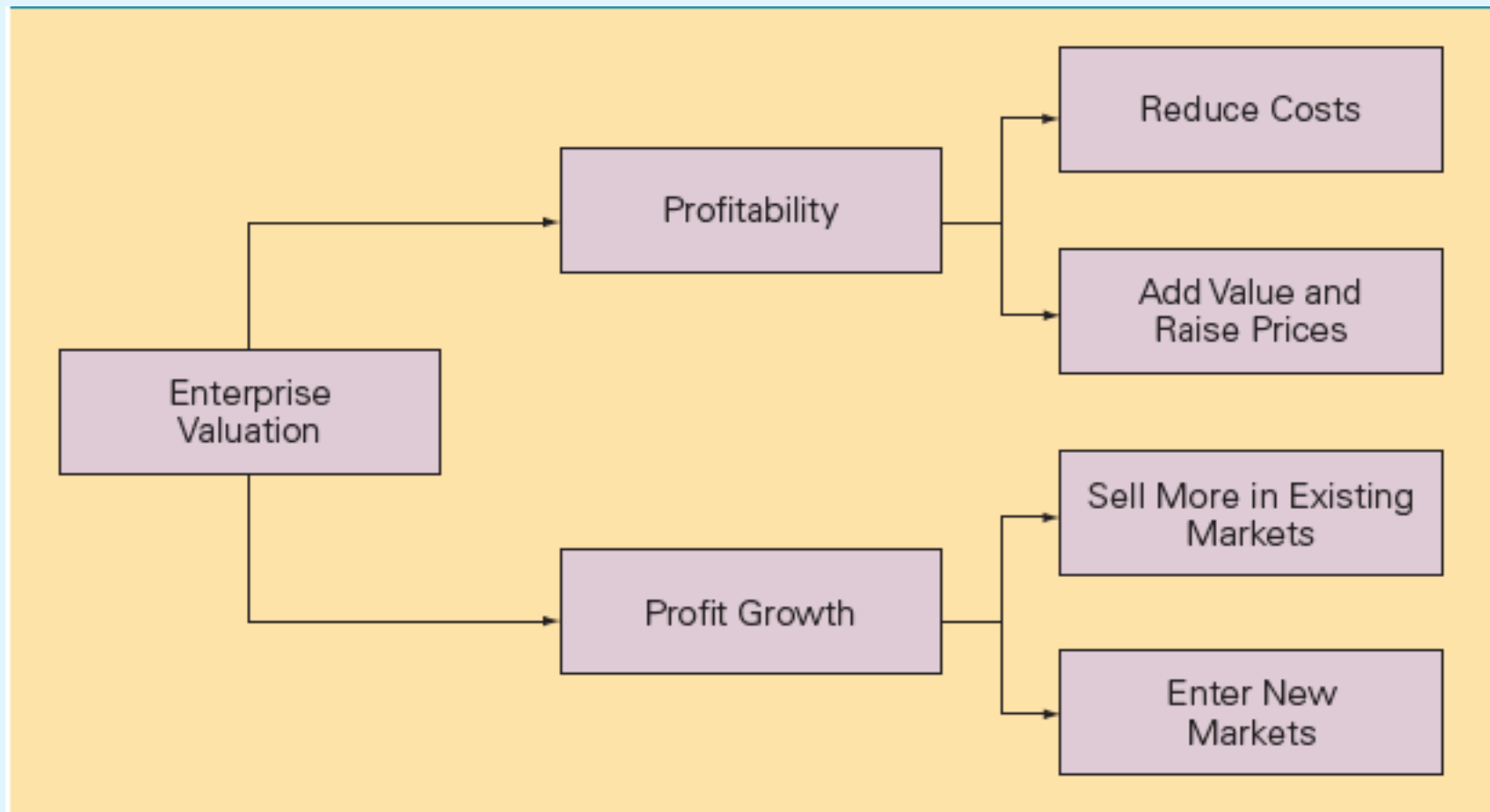
- A firm's **strategy** refers to the actions that managers take to attain the goals of the firm
- Firms need to pursue strategies that increase profitability and profit growth
  - **Profitability** is the rate of return the firm makes on its invested capital
  - **Profit growth** is the percentage increase in net profits over time

# What Is Strategy?

- To increase profitability and profit growth, firms can
  - add value
  - lower costs
  - sell more in existing markets
  - expand internationally

# What Is Strategy?

## Determinants of Enterprise Value

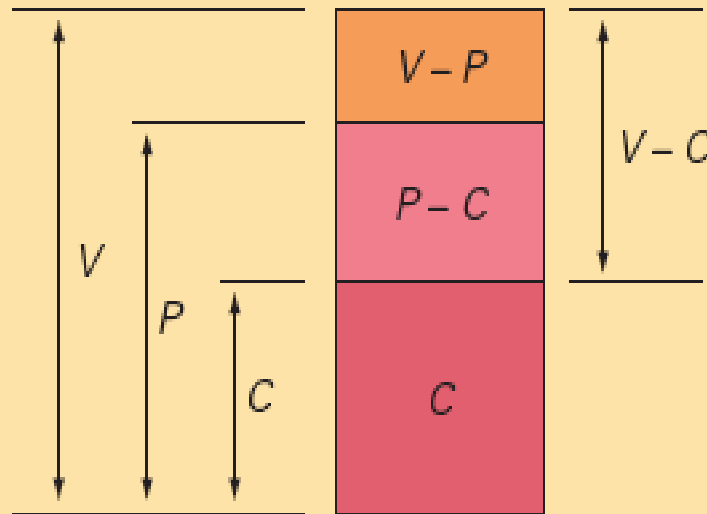


# How Is Value Created?

- To increase profitability, firms need to create more value
- The firm's **value creation** is the difference between  $V$  (the price that the firm can charge for that product given competitive pressures) and  $C$  (the costs of producing that product)
- a firm has high profits when it creates more value for its customers and does so at a lower cost

# How Is Value Created?

## Value Creation



$V$  = value of product to an average consumer

$P$  = price per unit

$C$  = cost of production per unit

$V - P$  = consumer surplus per unit

$P - C$  = profit per unit sold

$V - C$  = value created per unit

# How Is Value Created?

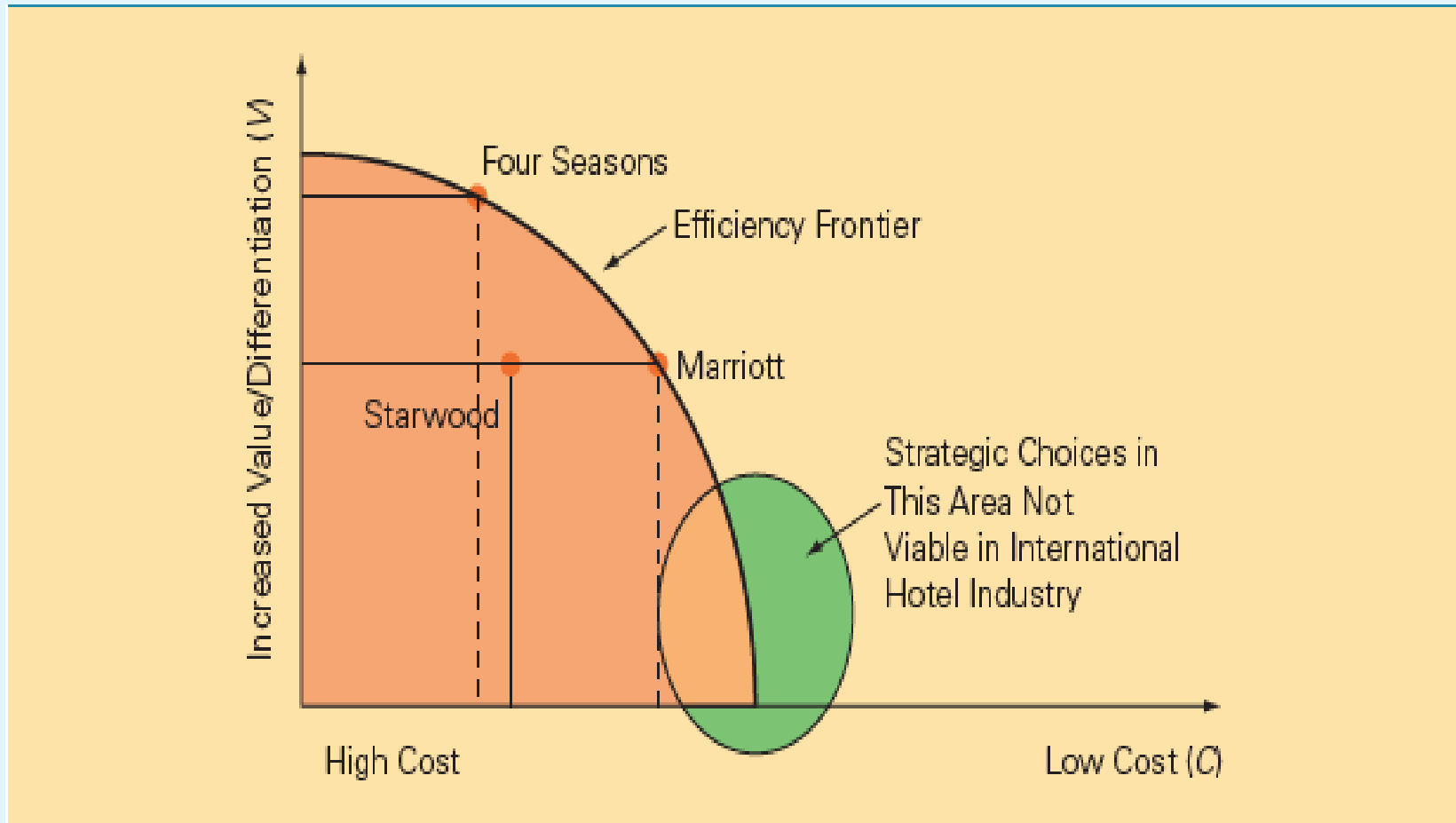
- Profits can be increased by
  1. Using a **differentiation strategy**
    - adding value to a product so that customers are willing to pay more for it
  2. Using a **low cost strategy**
    - lowering costs

# Why Is Strategic Positioning Important?

- Michael Porter argues that firms need to choose either differentiation or low cost, and then configure internal operations to support the choice
- So, to maximize long run return on invested capital, firms must
  - pick a viable position on the efficiency frontier
  - configure internal operations to support that position
  - have the right organization structure in place to execute the strategy

# Why Is Strategic Positioning Important?

Strategic Choice in the International Hotel Industry



# How Are a Firm's Operations Configured?

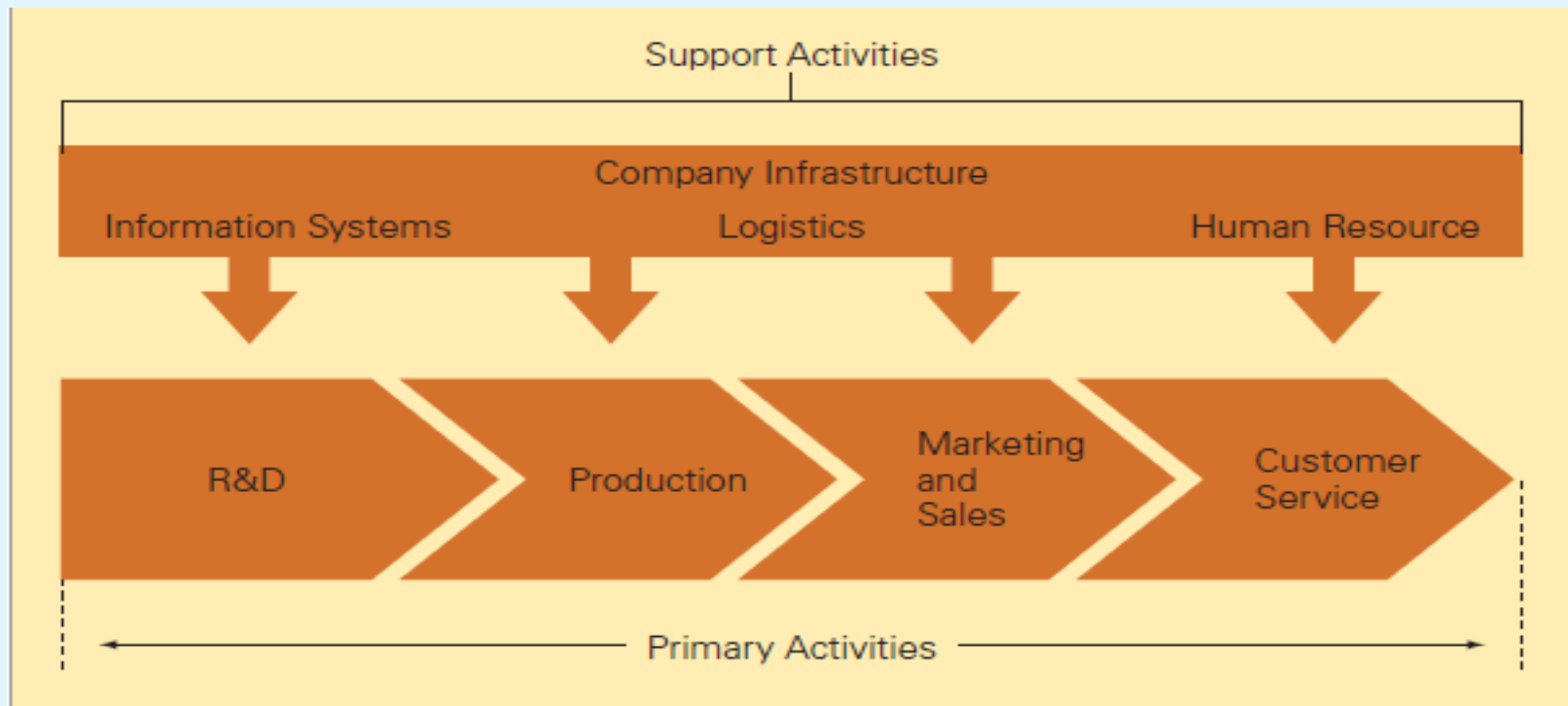
- A firm's **operations** are like a value chain composed of a series of distinct value creation activities:
  - production, marketing, materials management, R&D, human resources, information systems, and the firm infrastructure
- All of these activities must be managed effectively and be consistent with firm strategy

# How Are a Firm's Operations Configured?

- Value creation activities can be categorized as
  1. **Primary activities**
    - R&D
    - Production
    - marketing and sales
    - customer service
  2. **Support activities**
    - information systems
    - logistics
    - human resources

# How Are a Firm's Operations Configured?

The Value Chain



# How Can Firms Increase Profits Through International Expansion?

- International firms can
  1. Expand their market
    - sell in international markets
  2. Realize location economies
    - disperse value creation activities to locations where they can be performed most efficiently and effectively

# How Can Firms Increase Profits Through International Expansion?

## 3. Realize greater cost economies from experience effects

- serve an expanded global market from a central location

## 4. Earn a greater return

- leverage skills developed in foreign operations and transfer them elsewhere in the firm

# How Can Firms Leverage Their Products and Competencies?

- Firms can increase growth by selling goods or services developed at home internationally
- The success of firms that expand internationally depends on
  - the goods or services sold
  - the firm's **core competencies**

# How Can Firms Leverage Their Products and Competencies?

- **Core competencies** - skills within the firm that competitors cannot easily match or imitate
  - can exist in any value creation activity
- Core competencies allow firms to reduce the costs of value creation and/or to create perceived value so that premium pricing is possible

# Why Are Location Economies Important?

- **Location economies** are economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be
- By achieving location economies, firms can
  - lower the costs of value creation and achieve a low cost position
  - differentiate their product offering

# Why Are Location Economies Important?

- Firms that take advantage of location economies in different parts of the world, create a **global web** of value creation activities
- different stages of the value chain are dispersed to locations where perceived value is maximized or where the costs of value creation are minimized

# Why Are Experience Effects Important?

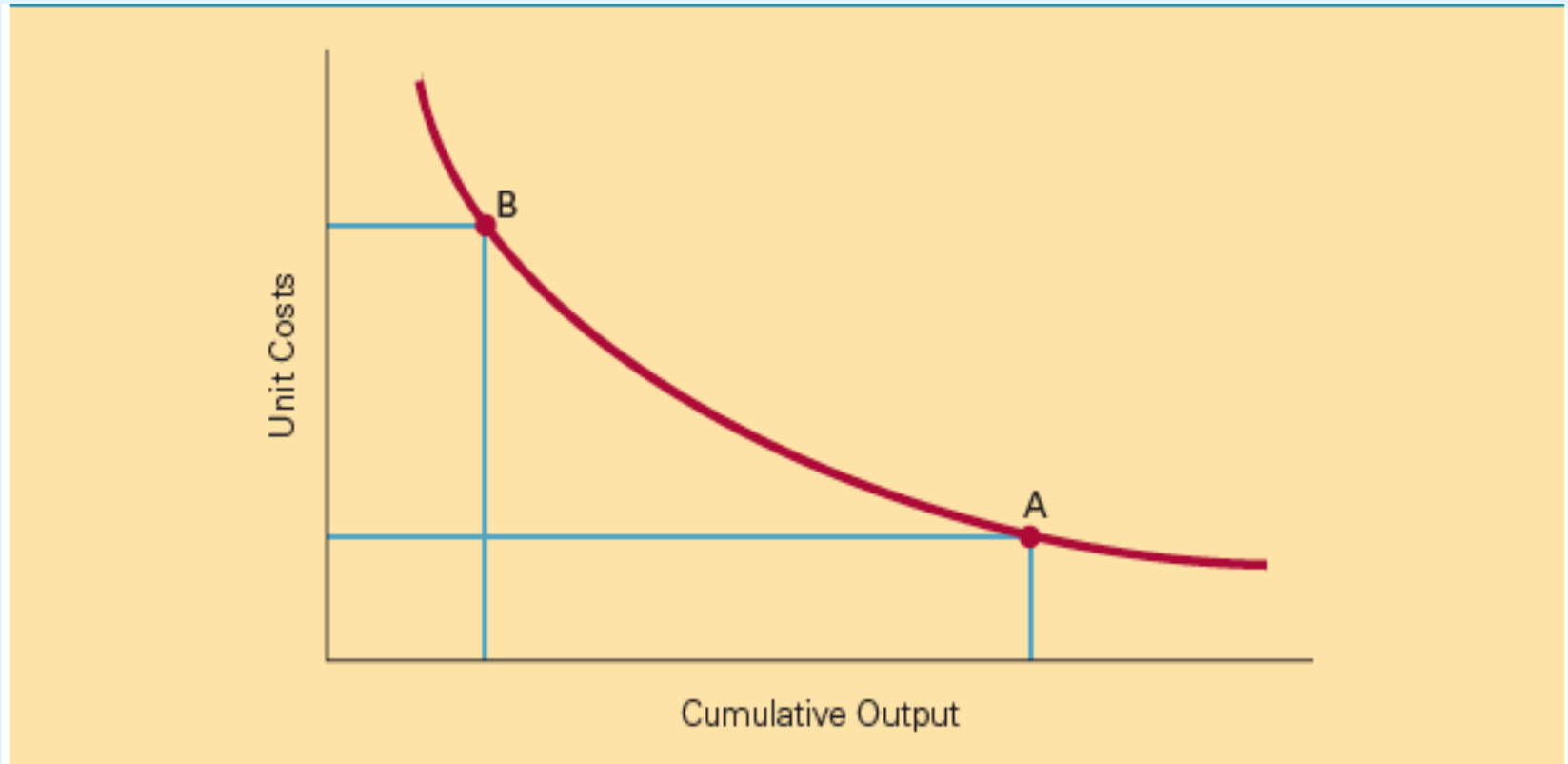
- The **experience curve** refers to the systematic reductions in production costs that occur over the life of a product
  - by moving down the experience curve, firms reduce the cost of creating value
  - to get down the experience curve quickly, firms can use a single plant to serve global markets

# Why Are Experience Effects Important?

- **Learning effects** are cost savings that come from learning by doing
- When labor productivity increases
  - individuals learn the most efficient ways to perform particular tasks
  - managers learn how to manage the new operation more efficiently

# Why Are Experience Effects Important?

The Experience Curve



# Why Are Experience Effects Important?

- **Economies of scale** - the reductions in unit cost achieved by producing a large volume of a product
- Sources of economies of scale include
  - spreading fixed costs over a large volume
  - utilizing production facilities more intensively
  - increasing bargaining power with suppliers

# How Can Managers Leverage Subsidiary Skills?

- Managers should
  1. Recognize that valuable skills that could be applied elsewhere in the firm can arise anywhere within the firm's global network - not just at the corporate center
  2. Establish an incentive system that encourages local employees to acquire new skills
  3. Have a process for identifying when valuable new skills have been created in a subsidiary
  4. Act as facilitators to help transfer skills within the firm

# What Types of Competitive Pressures Exist in the Global Marketplace?

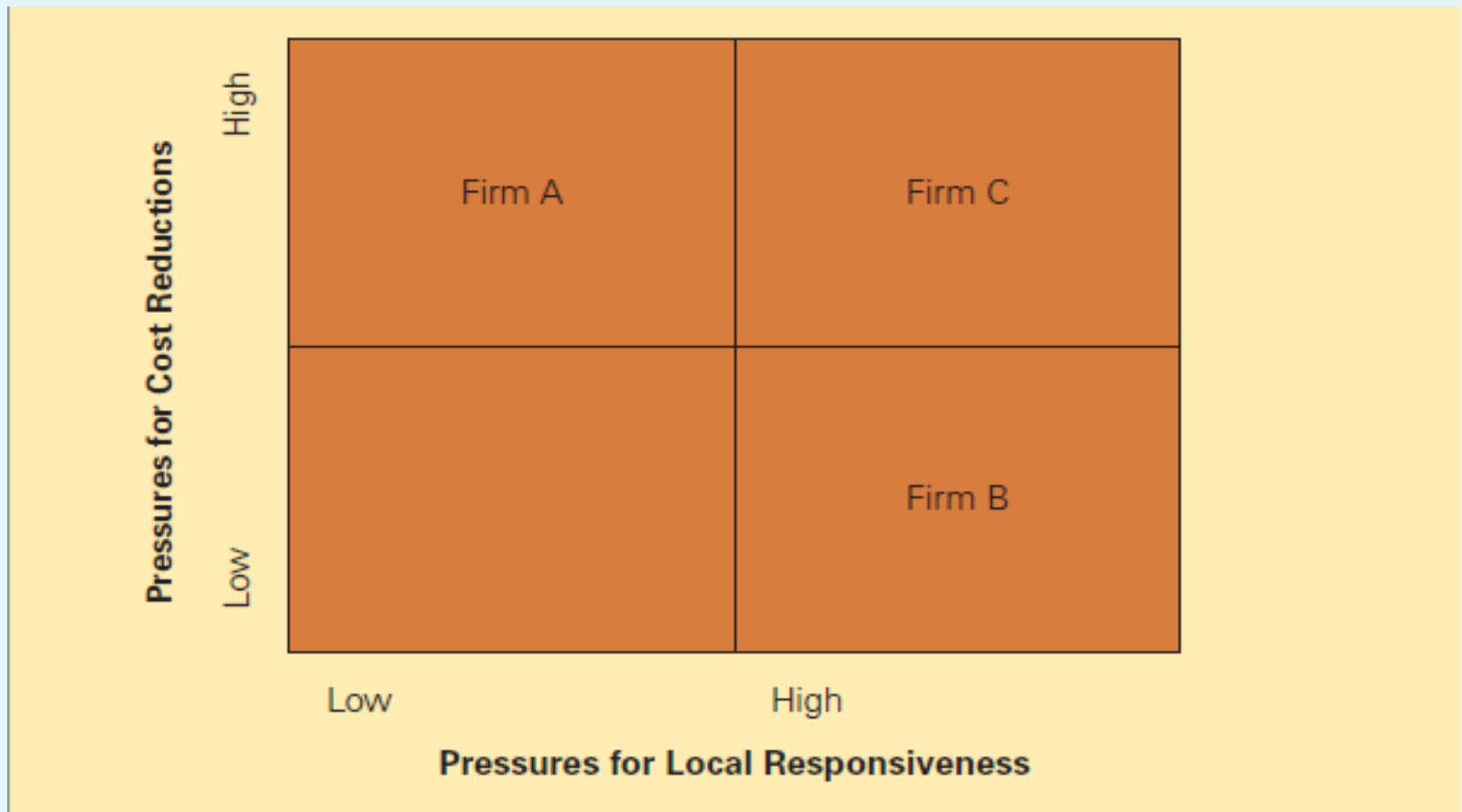
- Firms that compete in the global marketplace face two conflicting types of competitive pressures
  - the pressures limit the ability of firms to realize location economies and experience effects, leverage products, and transfer skills within the firm
- Dealing with both pressures is challenging

# What Types of Competitive Pressures Exist in the Global Marketplace?

- Two competitive pressures:
  1. Pressures for cost reductions
    - force the firm to lower unit costs
  2. Pressures to be locally responsive
    - require the firm to adapt its product to meet local demands in each market
    - but, this strategy can raise costs

# What Types of Competitive Pressures Exist in the Global Marketplace?

Pressures for Cost Reductions and Local Responsiveness



# When Are Pressures for Cost Reductions Greatest?

- Pressures for cost reductions are greatest
  1. In industries producing commodity type products that fill **universal needs** (needs that exist when the tastes and preferences of consumers in different nations are similar if not identical) where price is the main competitive weapon
  2. When major competitors are based in low cost locations
  3. Where there is persistent excess capacity
  4. Where consumers are powerful and face low switching costs

# When Are Pressures for Local Responsiveness Greatest?

- Pressures for local responsiveness arise from
  1. Differences in consumer tastes and preferences
    - strong pressure emerges when consumer tastes and preferences differ significantly between countries
  2. Differences in traditional practices and infrastructure
    - strong pressure emerges when there are significant differences in infrastructure and/or traditional practices between countries

# When Are Pressures for Local Responsiveness Greatest?

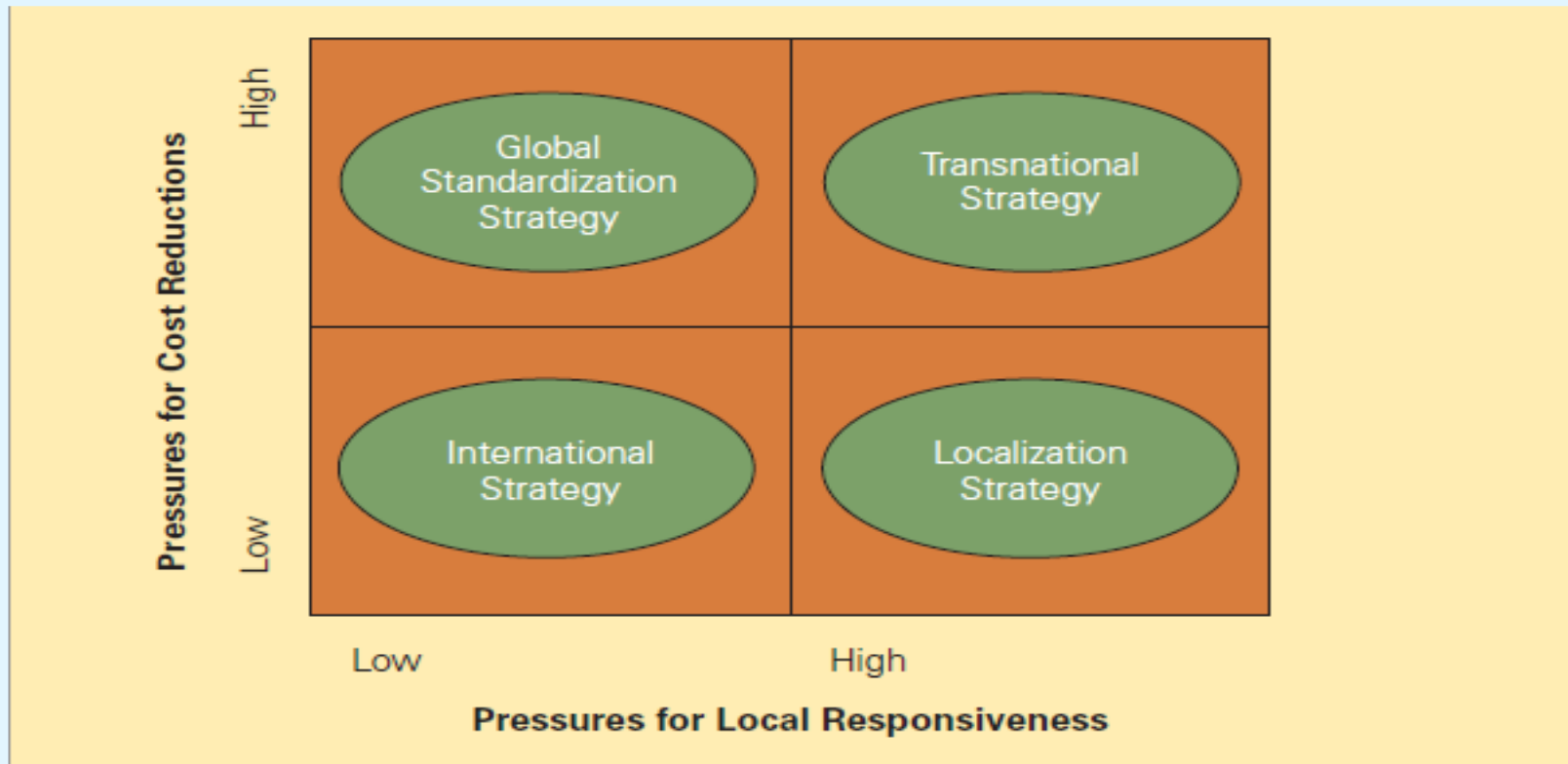
3. Differences in distribution channels
  - need to be responsive to differences in distribution channels between countries
4. Host government demands
  - economic and political demands imposed by host country governments may require local responsiveness

# Which Strategy Should a Firm Choose?

- There are four basic strategies to compete in international markets
  - the appropriateness of each strategy depends on the pressures for cost reduction and local responsiveness in the industry

# Which Strategy Should a Firm Choose?

## Four Basic Strategies



# Which Strategy Should a Firm Choose?

1. **Global standardization** - increase profitability and profit growth by reaping the cost reductions from economies of scale, learning effects, and location economies
  - goal is to pursue a low-cost strategy on a global scale
  - This strategy makes sense when
    - there are strong pressures for cost reductions and demands for local responsiveness are minimal

# Which Strategy Should a Firm Choose?

2. **Localization** - increase profitability by customizing goods or services so that they match tastes and preferences in different national markets
  - This strategy makes sense when
    - there are substantial differences across nations with regard to consumer tastes and preferences and cost pressures are not too intense

# Which Strategy Should a Firm Choose?

3. **Transnational** - tries to simultaneously achieve low costs through location economies, economies of scale, and learning effects
  - firms differentiate their product across geographic markets to account for local differences and foster a multidirectional flow of skills between different subsidiaries in the firm's global network of operations
  - This strategy makes sense when
    - both cost pressures and pressures for local responsiveness are intense

# Which Strategy Should a Firm Choose?

4. **International** – take products first produced for the domestic market and sell them internationally with only minimal local customization
  - This strategy makes sense when
    - there are low cost pressures and low pressures for local responsiveness

# How Does Strategy Evolve?

- An international strategy may not be viable in the long term
  - to survive, firms may need to shift to a global standardization strategy or a transnational strategy in advance of competitors
- Localization may give a firm a competitive edge, but if the firm is simultaneously facing aggressive competitors, the company will also have to reduce its cost structures
  - would require a shift toward a transnational strategy

# How Does Strategy Evolve?

Changes in Strategy over Time

