Red Bull, A Leader In International Strategy

opening case

Where does Red Bull hail from? Many people in the United States and in many other countries as well think that Red Bull is a local product in their country since Red Bull does such a fantastic job of marketing the company everywhere. Red Bull plays up the amazing energy, go-getter attitude, and fun risk-taking that the brand symbolizes in everything they do around the globe, "Red Bull gives you wings," as their slogan says. To support the company's international strategy, Red Bull hosts a number of extreme sporting events around the world. These include the Red Bull Indianapolis Grand Prix in the United States, Red Bull Air Race in the United Kingdom, Red Bull Soapbox Race in Jordan, Red Bull Cliff Diving World Series, Red Bull Air Race, Red Bull Crashed Ice, and stand-out stunts such as Stratos space diving. In addition, Red Bull maintains numerous other notable strategic placements globally of their brand.

Now, the answer to the opening question is that Red Bull is from Austria, although saying that it is an Austrian-Thai company may work also! In 1984, Austrian entrepreneur Dietrich Mateschitz and Thai businessperson Chaleo Yoovidhya founded Red Bull GmbH. While working for German manufacturer Blendax (later acquired by Procter & Gamble), Mateschitz traveled to Thailand and met Chaleo, owner of TC Pharmaceutical. The two struck a cord and eventually started Red Bull a couple of years after they met. Today, Red Bull is viewed as one of the world's top companies for its international strategy, in particular for its international marketing strategy (keep that in mind when you read Chapter 16: Global Marketing and Business Analytics later). Worldwide, Red Bull has the highest market share of all energy drinks, with more than 6 billion cans sold annually (that's almost one can for every person in the world).

Why is it called Red Bull? The name reflects its founders' backgrounds and the unique history of the enterprise. Thai company Krating Daeng had been founded by Chaleo; when Mateschitz met Chaleo, they created Red Bull as a spinoff and modified the ingredients in the energy drink to suit the tastes of Westerners. In Thai, *daeng* means red and *krating* is a large wild bovine in Southeast Asia informally referred to in English as a bull. Thus Red Bull, which is sold in a tall, slim blue-silver can. Krating Daeng is in a shorter gold can. Red Bull is viewed as an Austrian company and Krating Daeng as a Thai company. While Red Bull is the best-selling energy drink in most parts of the world, both Red Bull and Krating Daeng are sold worldwide (in about 165 countries).

In many ways, Red Bull's extreme-event marketing strategy is what drives their international business strategy. The events sponsored by Red Bull exemplify the brand that Red Bull has become, that it tries to strategically nurture, and that has built the company its reputation, really a "brand myth," that has become a legend. Red Bull mass markets its products in a unique way. They don't do regular marketing, and their overall international business strategy is somewhat unorthodox. Contrary to most other multinational

continued

corporations, the events and the teams they support (e.g., soccer/football clubs RB Leipzig, FC Red Bull Salzburg, FC Liefering, Red Bull Brasil, New York Red Bulls, and Formula One teams Red Bull Racing and Scuderia Toro Rosso) drive the company's international business strategy.

Aside from these extreme events and sporting teams, Red Bull's packaging also plays a significant part in its global appeal and is core to its international business strategy. Some say that Red Bull really looks like a product that fits the idea of a global economy. It's not in a normal can or bottle and its design has a much broader appeal to a wider global audience. It's not an American product in look and content, nor is it an Asian product in look or content, or the look and content of any other world area. By lacking a clear geographic focus, its sleek look appeals to customers globally who can form their own connection to the product. Thus the product seems adaptable to each local environment in which it is sold. Plus, Red Bull's consistent packaging worldwide has helped the brand go global with a very consistent international business strategy.

Red Bull has created an international business strategy by focusing on a universal product concept, unique and standout packaging, and extreme event sponsorship without also tackling the architecture of the company itself. Most other multinational corporations have to balance their focus on marketing strategy and organizational infrastructure to operate a well-functioning international strategy. Red Bull drives certain concepts hard and that works superbly well for them. They communicate their clear and consistent messages via their own Red Bull Media House, inspirational videos and activities on social media, and content marketing that is uniquely customized to diverse audiences. They focus on people having freedom and fun and rely on user-generated content where customers share their own exciting lifestyles. ●

Sources: Hanna Fleishman, "13 Businesses with Brilliant Global Marketing Strategies," *HubSpot*, February 9, 2018; Alex Siminoff, "Red Bull Stomps All Over Global Marketing," *Art + Marketing*, April 28, 2017; Nitin Pangarkar and Mohit Agarwal, "The Wind Behind Red Bull's Wings," *Forbes*, June 24, 2013; Celine Cnossen, Yuan Li, Neha Sampath, Whitney Taylor-Maisano, and Viktor Tsonev, "What Gives Red Bull Wings: Creating a Successful Market-Oriented Organization," American Marketing Association, April 24, 2018; and "Global Energy Drinks Market Opportunities 2018: Red Bull GmbH, Rockstar, Monster Energy, Amway Global," *Market Watch*, March 14, 2018.

Introduction

Up to this point in the text, we have focused on the worldwide environment in which small, medium, and large companies—multinational corporations and SMEs (small- and medium-sized enterprises)—compete in the global marketplace.[1] These "macro" chapters have included content on the different political, economic, and cultural institutions found in nations; the international trade and investment framework; and the international monetary system. Additionally, we've placed a strong emphasis on managerial implications associated with each of these macro topics, with separate sections in each of the chapters on what the macro topics mean for managerial strategy and action globally. This managerial focus has been complemented with Management Focus and Country Focus features throughout to capture the relevant learning in relation to running a global company.

Starting with this "strategy" chapter, our focus now shifts from the macro environment to the firm itself and, in particular, to the actions managers can take to compete more effectively as an international business.[2] To begin the sequence of chapters on running a firm, which comprise the remainder of the text, this chapter looks at how organizations can increase revenue (and profitability) by expanding their operations in foreign markets: This is international business strategy. Keep in mind that we distinguish between revenue and profit; even nonprofit companies need to make revenue to offsets costs. Profit-focused companies, with shareholders, on the other hand, often focus on making a profit in addition to revenue. In this context, we discuss the different strategies that firms pursue when competing around the world, consider the pros and cons of the strategies, and elaborate on the various factors that affect a firm's choice of international strategy. Key issues in this chapter are value creation, global value chains (which later on also ties to Chapter 15 on global supply chain management),[3] strategic alliances, and how small, medium, and large companies achieve superior performance.[4]

The overview of the strategy of Red Bull in the opening case shows a company that has developed a unique, energetic, and fluid approach to competing in the global marketplace. As we mentioned, many people in the United States and elsewhere think that Red Bull is a local product, because

strategically, Red Bull does such a great job of promoting a universal brand that customers in all countries can get attached to, buy into as their own "local" brand, and identify as "global" by its packaging. Red Bull communicates their messaging via their own Red Bull Media House, all the various social media, and content marketing that is customized to diverse audiences around the world.

To complement Red Bull's strategic uniqueness and effectiveness globally, the closing case of this chapter is about Sony Corporation. Sony's basic strategy is to first categorize their products and services into 12 core business segments—whereas Red Bull focuses on a universal global brand. Sony's structured approach—but also its focus on "strategic curiosity"—has made Sony a global innovator for more than seven decades. Beyond the 12 core segments that have served Sony well strategically for a long time, the company is embarking on global initiatives to create new business opportunities. They are accelerating research and development (R&D) activities to bring about innovations that can, if successful, become new strategic business segments serving customers' needs and wants. The differences between Red Bull and Sony in international strategy are clear: one company has an almost universal appeal to customers and drives that point home in sponsored events and content marketing (Red Bull), while the other has a very structurally defined approach to international strategy (Sony).

The cases of Red Bull and Sony illustrate this chapter's themes of value creation, strategic positioning, value chain operations, global expansion opportunities, cost pressures, and choosing a strategy that fits with the core business model of a company in its industry. These elements of international business strategy have long been the core domains of companies' strategy globally, and something that all companies can leverage to do well in the markets they choose to engage in. Red Bull and Sony have both been very successful in their global strategy development and implementation but for vastly different reasons. For each company, however, value creation and strategic positioning were the initial drivers of success, and these topics are covered in the first section of this chapter.

Before we move on, let's highlight the final topic in this chapter, which is the idea of entering into strategic alliances. **Strategic alliances** are cooperative agreements between potential or actual competitors. The term is often used to embrace a variety of agreements between actual or potential competitors, including cross-shareholding deals, licensing arrangements, formal joint ventures, and informal cooperative arrangements. The motives for entering strategic alliances are varied, but they often include market access, which overlaps with the topic of entering foreign markets which we will cover in detail in Chapter 13.

strategic alliances
Cooperative agreements between potential or actual competitors.

Strategy and the Firm

LO 12-1
Explain the concept of international business strategy.

When we talk about strategy and the firm, we refer to the firm in the most common way as a method to organize activities. This means that the firm can also be called a multinational enterprise, multinational corporation, international business, international organization, global company, and so on. A unique type of firm, though, is what we call an SME—a small- or medium-sized enterprise. SMEs are companies that have fewer than 500 employees (U.S.) or fewer than 250 employees (Europe). Throughout the text, we use a variety of terminologies in largely the same context for the larger firms, but we specify when we talk about SMEs since these companies have global strategies that sometimes differ from their larger counterparts.[5] However, importantly, whereas most textbooks in business focus on large companies, we take great pride and have dedicated our effort to discuss content as it relates to small and medium-sized, as well as large, firms.

Before we discuss the strategies that managers in the multinational enterprise can pursue, we need to review some basic principles of strategy. A firm's **strategy** can be defined as the actions that managers take to attain the goals of the firm. For most firms, the preeminent goal is to maximize the value of the firm for its owners and its shareholders (subject to the very important constraint that the activities undertaken are done in a legal, ethical, and socially responsible manner—see Chapter 5 for details). To maximize the value of a firm to shareholders, managers must pursue strategies that increase the *profitability* of the enterprise and its rate of *profit growth* over time (see Figure 12.1). **Profitability** can be measured in a number of ways, but for consistency, we define it as the rate of return that the firm makes on its invested capital (return-on-investments, abbreviated as ROI), which is calculated by dividing the net profits of the firm by total invested capital.[6] **Profit growth** is measured by the percentage increase in net profits over time. In general, higher profitability and a higher rate of profit growth will increase the value of an enterprise and thus the returns garnered by its owners, the shareholders.[7]

strategy
Actions managers take to attain the firm's goals.

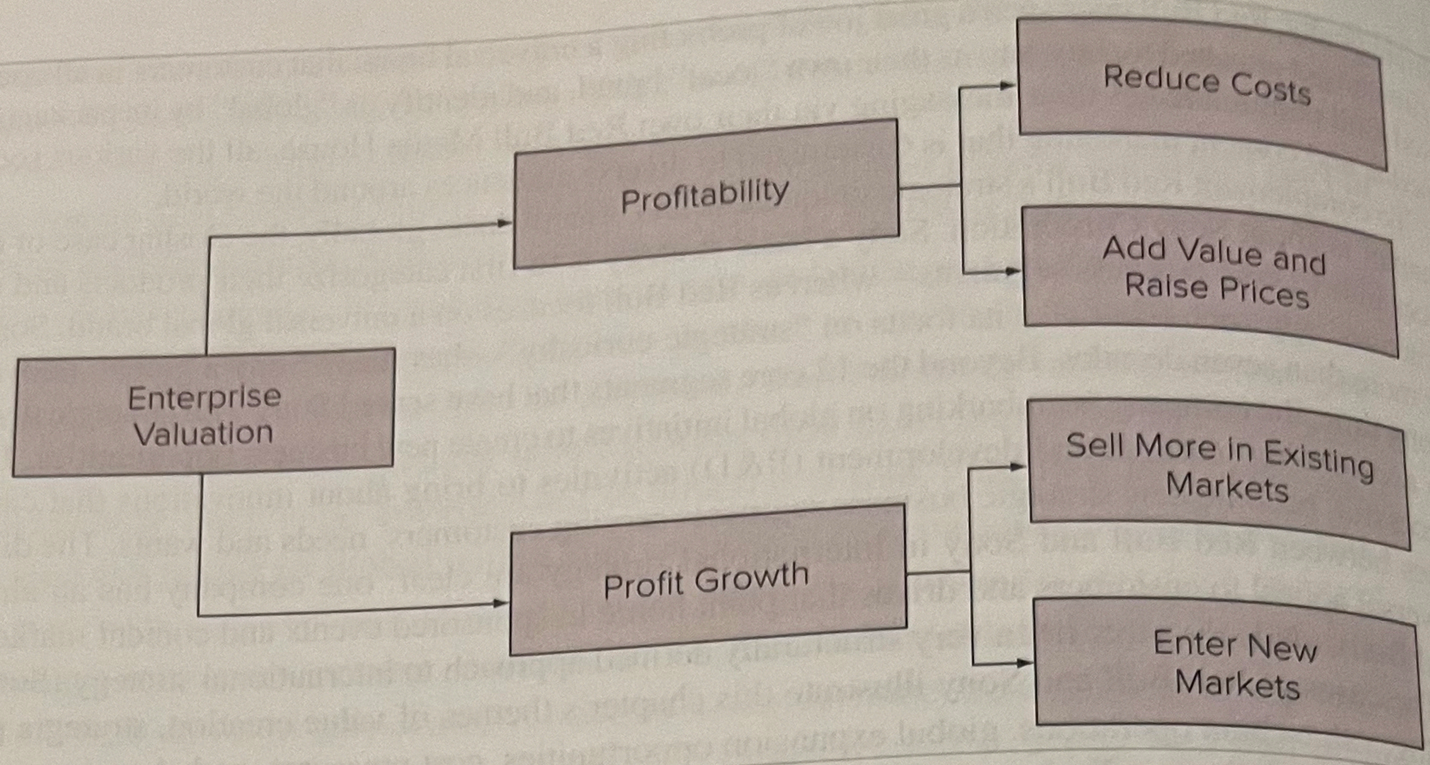
profitability
A ratio or rate of return concept.

profit growth
The percentage increase in net profits over time.

12.1 FIGURE

Determinants of enterprise value.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).



Managers can increase the profitability of the firm by pursuing strategies that lower costs or by pursuing strategies that add value to the firm's products, which enables the firm to raise prices. Managers can increase the rate at which the firm's profits grow over time by pursuing strategies to sell more products in existing markets or by pursuing strategies to enter new markets. As we shall see, expanding internationally can help managers boost the firm's profitability *and* increase the rate of profit growth over time.

Did You Know?

Did you know FedEx's global strategy focuses on more than transportation?

Visit your Connect SmartBook® to view a short video explanation from the authors.

VALUE CREATION

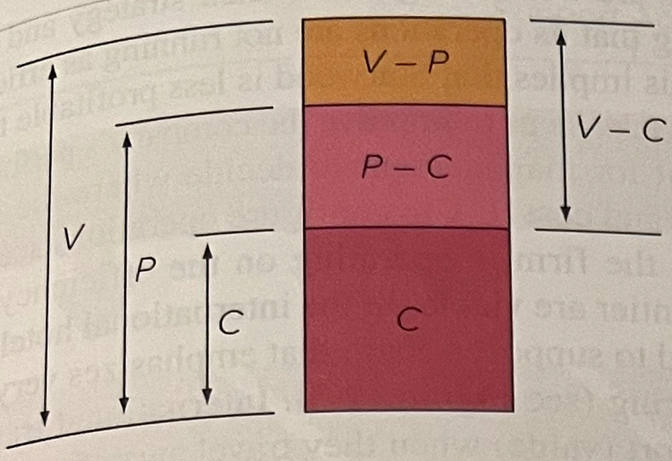
The way to increase the profitability of a firm is to create more value. The amount of value a firm creates is measured by the difference between its costs of production and the value that consumers perceive in its products. In general, the more value customers place on a firm's products, the higher the price the firm can charge for those products. However, the price a firm charges for a good or service is typically less than the value placed on that good or service by the customer. This is because the customer captures some of that value in the form of what economists call a consumer surplus.[8] The customer is able to do this because the firm is competing with other firms for the customer's business, so the firm must charge a lower price than it could were it a monopoly supplier. Also, it is normally impossible to segment the market to such a degree that the firm can charge each customer a price that reflects that individual's assessment of the value of a product, which economists refer to as a customer's reservation price. For these reasons, the price that gets charged tends to be less than the value placed on the product by many customers.

Figure 12.2 illustrates these concepts. The value of a product to an *average* consumer is V, the average price that the firm can charge a consumer for that product given competitive pressures and its ability to segment the market is P, and the average unit cost of producing that product is C (C comprises all relevant costs, including the firm's cost of capital). The firm's profit per unit sold (π) is equal to $P - C$, while the consumer surplus per unit is equal to $V - P$ (another way of thinking of the consumer surplus is as "value for the money"; the greater the consumer surplus, the greater the value for the money the consumer gets). The firm makes a profit so long as P is greater than C, and its profit will be greater the lower C is *relative* to P. The difference between V and P is in part determined by the intensity of competitive pressure in the marketplace: the lower the intensity of competitive pressure, the higher the price charged relative to V.[9] In general, the higher the firm's profit per unit sold is, the greater its profitability will be, all else being equal.

value creation

Performing activities that increase the value of goods or services to consumers.

The firm's **value creation** is measured by the difference between V and C ($V - C$); a company creates value by converting inputs that cost C into a product on which consumers place a value of V. A company can create more value ($V - C$) either by lowering production costs, C, or by making the product more attractive through superior design, styling, functionality, features, reliability, after-sales service, and the like, so that consumers place a greater value on it (V increases) and, consequently, are willing to pay a higher price (P increases). This discussion suggests that *a firm has high profits when it creates more value for its customers and does so at a lower cost*. We refer to a strategy that



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

12.2 FIGURE

Value creation.

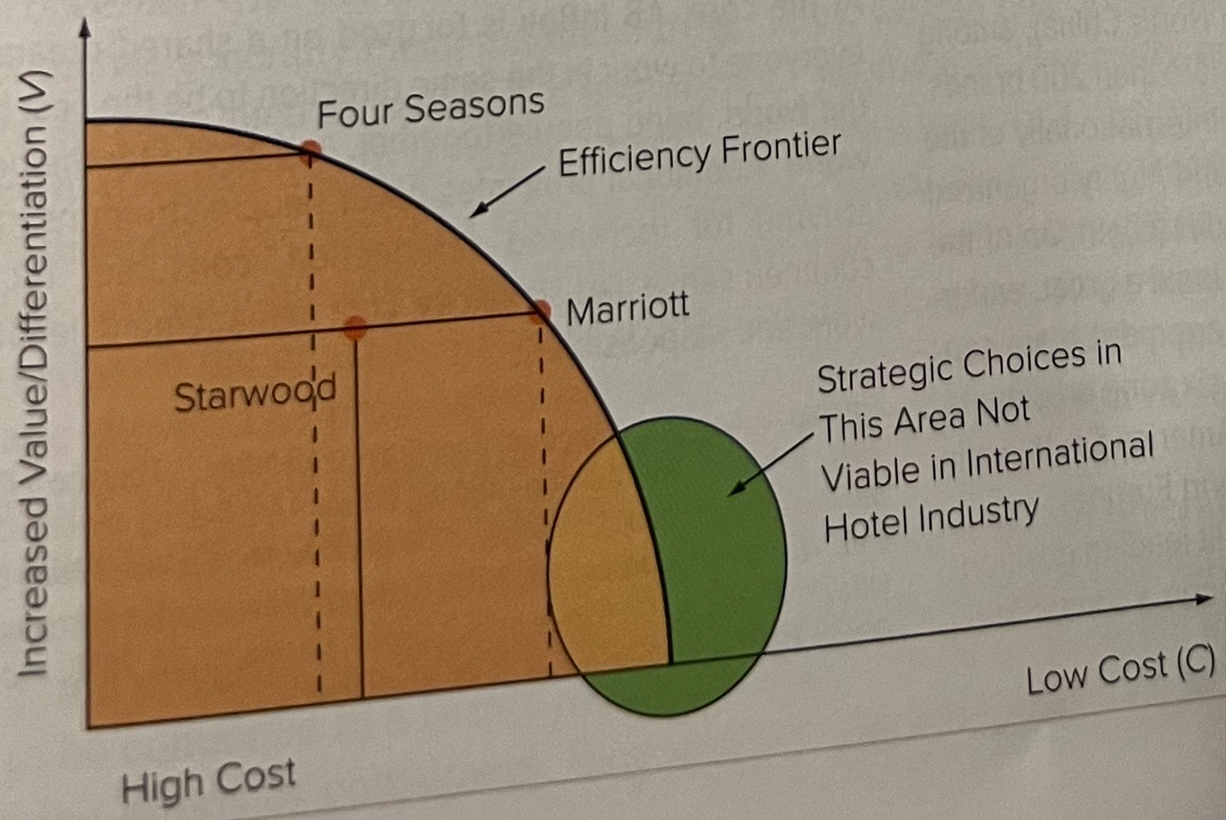
Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).

focuses primarily on lowering production costs as a *low-cost strategy*. We refer to a strategy that focuses primarily on increasing the attractiveness of a product as a *differentiation strategy*.[10]

Michael Porter has argued that *low cost* and *differentiation* are two basic strategies for creating value and attaining a competitive advantage in an industry.[11] According to Porter, superior profitability goes to those firms that can create superior value, and the way to create superior value is to drive down the cost structure of the business and/or differentiate the product in some way so that consumers value it more and are prepared to pay a premium price. Superior value creation relative to rivals does not necessarily require a firm to have the lowest cost structure in an industry or to create the most valuable product in the eyes of consumers. However, it does require that the gap between value (V) and cost of production (C) be greater than the gap attained by competitors.

STRATEGIC POSITIONING Porter notes that it is important for a firm to be explicit about its choice of strategic emphasis with regard to value creation (differentiation) and low cost and to configure its internal operations to support that strategic emphasis.[12] Figure 12.3 illustrates this point. The convex curve in Figure 12.3 is what economists refer to as an efficiency frontier. The efficiency frontier shows all of the different positions that a firm can adopt with regard to adding value to the product (V) and low cost (C), assuming that its internal operations are configured efficiently to support a particular position (note that the horizontal axis in Figure 12.3 is reverse scaled; moving along the axis to the right implies lower costs). The efficiency frontier has a convex shape because of diminishing returns. Diminishing returns imply that when a firm already has significant value built into its product offering, increasing value by a relatively small amount requires significant additional costs. The converse also holds: when a firm already has a low-cost structure, it has to give up a lot of value in its product offering to get additional cost reductions.

Figure 12.3 plots three hotel firms with a global presence that cater to international travelers: Four Seasons, Marriott International, and Starwood (Starwood owns the Sheraton and Westin chains). Four Seasons positions itself as a luxury chain and emphasizes the value of its product offering, which drives up its costs of operations. Marriott and Starwood are positioned more in the middle of the market. Both emphasize sufficient value to attract international business travelers but are not luxury chains like Four Seasons. In Figure 12.3, Four Seasons and Marriott are shown to be on the efficiency



12.3 FIGURE

Strategic choice in the international hotel industry.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).

frontier, indicating that their internal operations are well configured to their strategy and run efficiently. Starwood is inside the frontier, indicating that its operations are not running as efficiently as they might be and that its costs are too high. This implies that Starwood is less profitable than Four Seasons and Marriott and that its managers must take steps to improve the company's performance.

Porter emphasizes that it is very important for management to decide where the company wants to be positioned with regard to value (V) and cost (C), to configure operations accordingly, and to manage them efficiently to make sure the firm is operating on the efficiency frontier. However, not all positions on the efficiency frontier are viable. In the international hotel industry, for example, there might not be enough demand to support a chain that emphasizes very low cost and strips all the value out of its product offering (see Figure 12.3). International travelers are relatively affluent and expect a degree of comfort (value) when they travel away from home.

A central tenet of the basic strategy paradigm is that to maximize its profitability, a firm must do three things: (1) pick a position on the efficiency frontier that is viable in the sense that there is enough demand to support that choice; (2) configure its internal operations, such as manufacturing, marketing, logistics, information systems, human resources, and so on, so that they support that position; and (3) make sure that the firm has the right organization structure in place to execute its strategy. *The strategy, operations, and organization of the firm must all be consistent with each other if it is to attain a competitive advantage and garner superior profitability.* By operations, we mean the different value creation activities a firm undertakes, which we shall review next. The accompanying Management Focus provides an illustration of how AB InBev creates value in the beer industry globally by adopting a strategy paradigm that is centered on maximizing profitability.

management FOCUS

AB InBev, Beer Globally, and Creating Value

The company AB InBev may not sound familiar to everyone, but spelled out, its name likely becomes clearer to most people, especially the beer-loving population of the world. Anheuser-Busch InBev originates from the Den Hoorn brewery in Leuven, Belgium, which dates back to 1366, and the pioneering spirit of the Anheuser & Co brewery, with origins in St. Louis, Missouri, since 1852. Today, AB InBev is the leading global brewer and one of the world's top consumer products companies.

AB InBev has operations in 25 countries, sales in more than 100 countries, revenue of $44 billion, 155,000 employees, and seven of the top 10 most valuable beer brands. These seven brands are: Budweiser, Bud Light, Stella Artois, Skol, Corona, Brahma, and Modelo Especial. Budweiser, Corona, and Stella Artois are marketed as "global brands," while Beck's, Leffe, and Hoegaarden are considered "international brands" in AB InBev's brand portfolio. The company also has 15 "local champions," which represent leadership in their respective local markets. These local brands include Jupiler (most popular beer in Belgium), Quilmes (original Argentinean lager since 1890), and Harbin (from the oldest brewery in North China), among the portfolio. In total, AB InBev's portfolio consists of more than 200 brands.

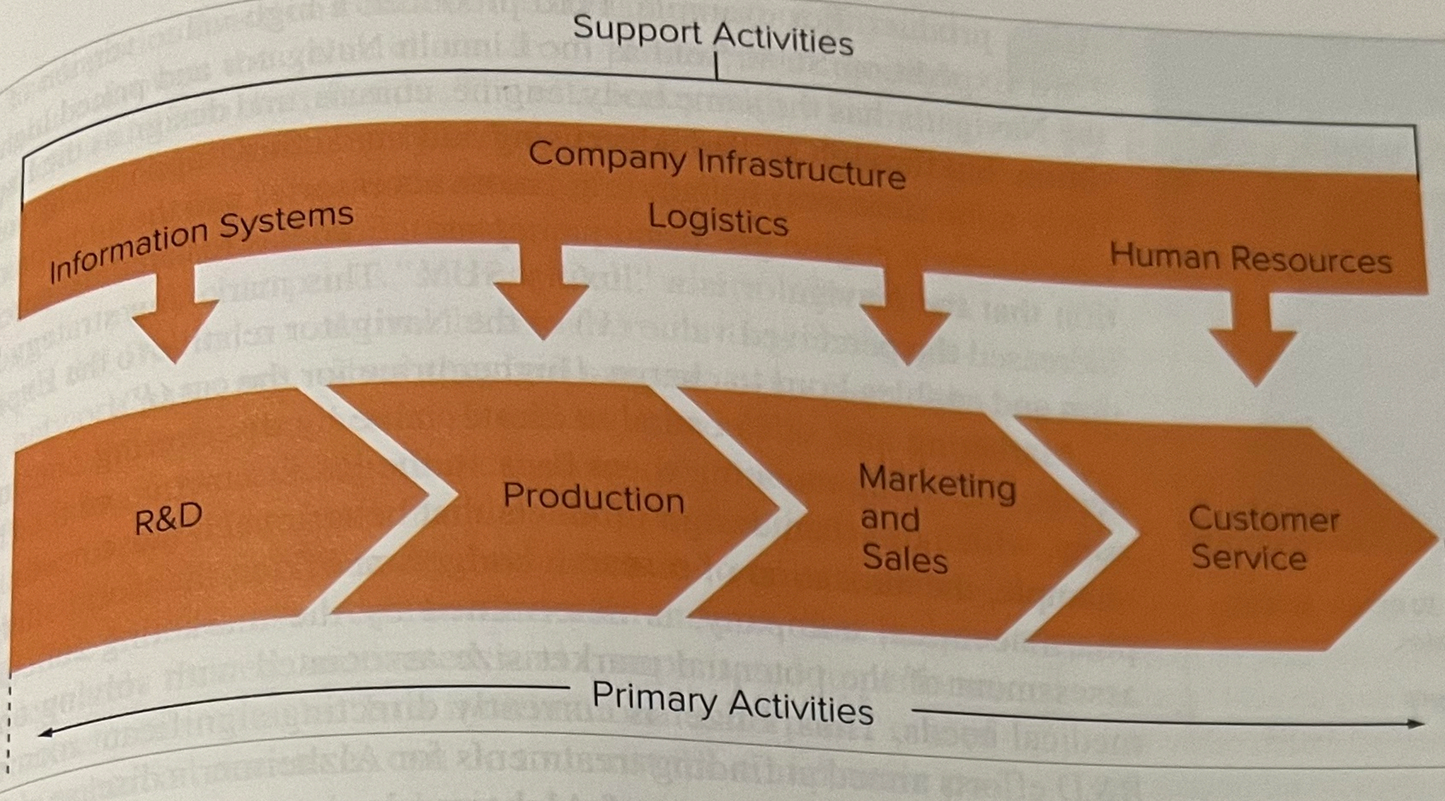
With more than 200 brands and strong coverage internationally of the different brands, strategically AB InBev is a unique and highly organized global company. Carlos Brito (CEO) and Olivier Goudet (chairman of the board) have stated that the company's ambition is to build a great, enduring company for the next 100 years. The core management team consists of the CEO, nine Executive Board members, and six zone presidents. The six zone presidents have responsibility for Latin America South, Latin America North, Asia Pacific, North America, Mexico, and Europe.

Using this management structure, AB InBev has built leading positions in the important beer profit markets in the world through a combination of organic growth and selected, value-enhancing acquisitions. The company follows a focused brands strategy in which the majority of the resources are devoted to those brands that have the greatest long-term growth potential. Investment behind the brands is fueled by a disciplined approach to cost management and efficiency. AB InBev has a strong track record of industry-leading margins and cash flow generation. In 2015, this led to growth of 12.6 percent of the company's three global brands (Budweiser, Corona, and Stella Artois), for example, and strong earnings in North America and most of Latin America.

The foundation for AB InBev's global strategy is the company's "Dream-People-Culture" approach. The goal is that despite having operations in many countries around the world, with different national cultures, AB InBev operates as one company, with one dream and one culture uniting them. There is also a focus on having the right people in the right place at the right time. This culture is built on ownership, informality, candor, transparency, and meritocracy.

Strategically, AB InBev has 10 principles driving everything they do. At the core, AB InBev is focused on a shared dream that energizes everyone to work in the same direction to be the best beer company in the world, bring people together, and aspire for the betterment of the world. Additional principles cover people strengths, quality of teams, striving for increased satisfaction, consumer focus, ownership, common sense and simplicity, cost management, leadership, and hard work and responsibility.

Sources: D. Leonard, "Can Craft Beer Survive AB InBev?" *Bloomberg Business*, June 25, 2015; V. Wong, "Why AB InBev and Big Brewers Are Betting on Hard Cider," *Bloomberg Business*, May 13, 2013; J. Colley, "The Big Beer Merger Won't Bring Down the Price of a Pint," *Newsweek*, October 18, 2015; C. Purdy, "There's a Less Obvious Reason Why AB InBev Is Buying Up Craft Breweries," *Quartz*, December 23, 2015; and *AB InBev Annual Report 2015*, http://annualreport.ab-inbev.com.



12.4 FIGURE

The value chain.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).

OPERATIONS: THE FIRM AS A VALUE CHAIN

The **operations** of a firm can be thought of as a value chain composed of a series of distinct value creation activities, including production, marketing and sales, materials management, research and development, human resources, information systems, and the firm infrastructure. We can categorize these value creation activities, or operations, as primary activities and support activities (see Figure 12.4).[13] As noted earlier, if a firm is to implement its strategy efficiently and position itself on the efficiency frontier shown in Figure 12.3, it must manage these activities effectively and in a manner that is consistent with its strategy.

operations
The various value creation activities a firm undertakes.

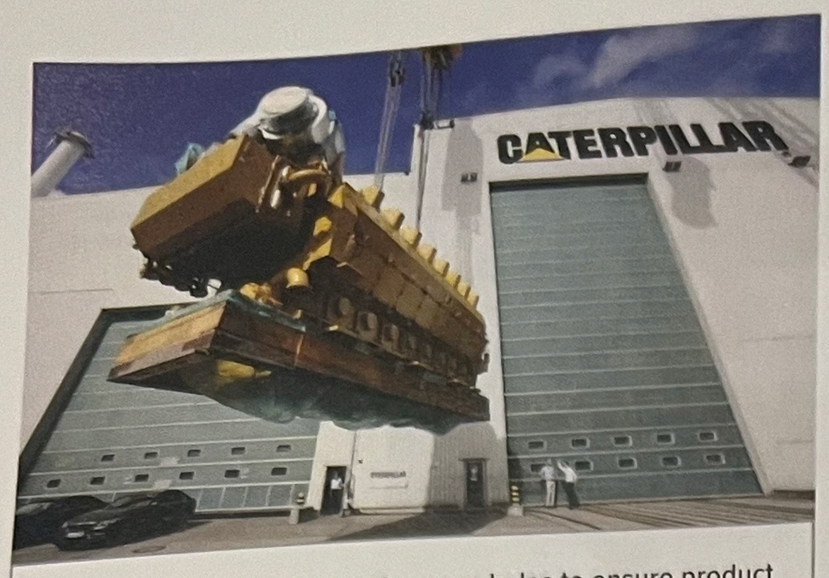
Primary Activities

Primary activities have to do with the design, creation, and delivery of the product; its marketing; and its support and after-sale service. Following normal practice, in the value chain illustrated in Figure 12.4, the primary activities are divided into four functions: research and development, production, marketing and sales, and customer service.

Research and development (R&D) is concerned with the design of products and production processes. Although we think of R&D as being associated with the design of physical products and production processes in manufacturing enterprises, many service companies also undertake R&D. For example, banks compete with each other by developing new financial products and new ways of delivering those products to customers. Online banking and smart debit cards are two examples of product development in the banking industry. Earlier examples of innovation in the banking industry included automated teller machines, credit cards, and debit cards. Through superior product design, R&D can increase the functionality of products, which makes them more attractive to consumers (raising V). Alternatively, R&D may result in more efficient production processes, thereby cutting production costs (lowering C). Either way, the R&D function can create value.

Production is concerned with the creation of a good or service. For physical products, when we talk about production, we generally mean manufacturing. Thus, we can talk about the production of an automobile. For services such as banking or health care, "production" typically occurs when the service is delivered to the customer (e.g., when a bank originates a loan for a customer, it is engaged in "production" of the loan). For a retailer such as Walmart, "production" is concerned with selecting the merchandise, stocking the store, and ringing up the sale at the cash register. For MTV, production is concerned with the creation, programming, and broadcasting of content, such as music videos and thematic shows. The production activity of a firm creates value by performing its activities efficiently so lower costs result (lower C) and/or by performing them in such a way that a higher-quality product is produced (which results in higher V).

The marketing and sales functions of a firm can help to create value in several ways. Through brand positioning and advertising, the marketing function can increase the value (V) that consumers perceive to be contained in a firm's product. If these create a favorable impression of the firm's product in the minds of consumers, they increase the price that can be charged for the



A Caterpillar motor factory in Germany helps to ensure product after-sales and service outside the United States.

©Bernd Wustneck/picture-alliance/dpa/AP Images

firm's product. For example, Ford produced a high-value version of its Ford Expedition SUV. Sold as the Lincoln Navigator and priced higher, the Navigator has the same body, engine, chassis, and design as the Expedition, but through skilled advertising and marketing, supported by some fairly minor features changes (e.g., more accessories and the addition of a Lincoln-style engine grille and nameplate), Ford has fostered the perception that the Navigator is a "luxury SUV." This marketing strategy has increased the perceived value (V) of the Navigator relative to the Expedition and enables Ford to charge a higher price for the car (P).

Marketing and sales can also create value by discovering consumer needs and communicating them back to the R&D function of the company, which can then design products that better match those needs. For example, the allocation of research budgets at Pfizer, the world's largest pharmaceutical company, is determined by the marketing function's assessment of the potential market size associated with solving unmet medical needs. Thus, Pfizer is currently directing significant monies to R&D efforts aimed at finding treatments for Alzheimer's disease, principally because marketing has identified the treatment of Alzheimer's as a major unmet medical need in nations around the world where the population is aging.

The role of the enterprise's service activity is to provide after-sale service and support. This function can create a perception of superior value (V) in the minds of consumers by solving customer problems and supporting customers after they have purchased the product. Caterpillar, the U.S.-based manufacturer of heavy earthmoving equipment, can get spare parts to any point in the world within 24 hours, thereby minimizing the amount of downtime its customers have to suffer if their Caterpillar equipment malfunctions. This is an extremely valuable capability in an industry where downtime is very expensive. It has helped to increase the value that customers associate with Caterpillar products and thus the price that Caterpillar can charge.

Support Activities The support activities of the value chain provide inputs that allow the primary activities to occur (see Figure 12.4). In terms of attaining a competitive advantage, support activities can be as important as, if not more important than, the primary activities of the firm. Consider information systems: these systems refer to the electronic systems for managing inventory, tracking sales, pricing products, selling products, dealing with customer service inquiries, and so on. Information systems, when coupled with the communications features of the Internet, can alter the efficiency and effectiveness with which a firm manages its other value creation activities. Dell, for example, has used its information systems to attain a competitive advantage over rivals. When customers place an order for a Dell product over the firm's website, that information is immediately transmitted, via the Internet, to suppliers, who then configure their production schedules to produce and ship that product so that it arrives at the right assembly plant at the right time. These systems have reduced the amount of inventory that Dell holds at assembly plants to under two days, which is a major source of cost savings.

globalEDGE

Business BEAT

In Chapter 12, we are bringing you closer to running an international firm based on the issues we have covered on country differences, global trade and investment environment, and the global money system. This is where many of you will "make your money" as strategic decision makers in corporations. This also means that you need to know what is current, important, and strategic in the global marketplace; your company's products or services; and your company's uniqueness in satisfying the needs and wants of customers. The globalEDGE™ Business Beat (gBB) is a radio show that covers discussions with a wide range of global leaders in business, government, and academe to educate the listeners about the latest thoughts, tools, and markets to succeed globally (http://globaledge.msu.edu/get-connected/globaledge-business-beat). Tomas Hult, coauthor of this textbook, is the host of gBB, and Charles W. L. Hill, the textbook's lead author, is regularly featured on the show.

The logistics function controls the transmission of physical materials through the value chain, from procurement through production and into distribution. The efficiency with which this is carried out can significantly reduce cost (lower C), thereby creating more value. The combination of logistics systems and information systems is a particularly potent source of cost savings in many enterprises, such as Dell, where information systems tell Dell on a real-time basis where in its global logistics network parts are, when they will arrive at an assembly plant, and thus how production should be scheduled.

The human resource function can help create more value in a number of ways. It ensures that the company has the right mix of skilled people to perform its value creation activities effectively. The human resource function also ensures that people are adequately trained, motivated, and compensated to perform their value creation tasks. In a multinational enterprise, one of the things human resources can do to boost the competitive position of the firm is to take advantage of its transnational reach to identify, recruit, and develop a cadre of skilled managers, regardless of their nationality, who can be groomed to take on senior management positions. They can find the very best, wherever they are in the world. Indeed, the senior management ranks of many multinationals are becoming increasingly diverse, as managers from a variety of national backgrounds have ascended to senior leadership positions.

The final support activity is the company infrastructure, or the context within which all the other value creation activities occur. The infrastructure includes the organizational structure, control systems, and culture of the firm. Because top management can exert considerable influence in shaping these aspects of a firm, top management should also be viewed as part of the firm's infrastructure. Through strong leadership, top management can consciously shape the infrastructure of a firm and through that the performance of all its value creation activities.

Is Education Creating Value for You?

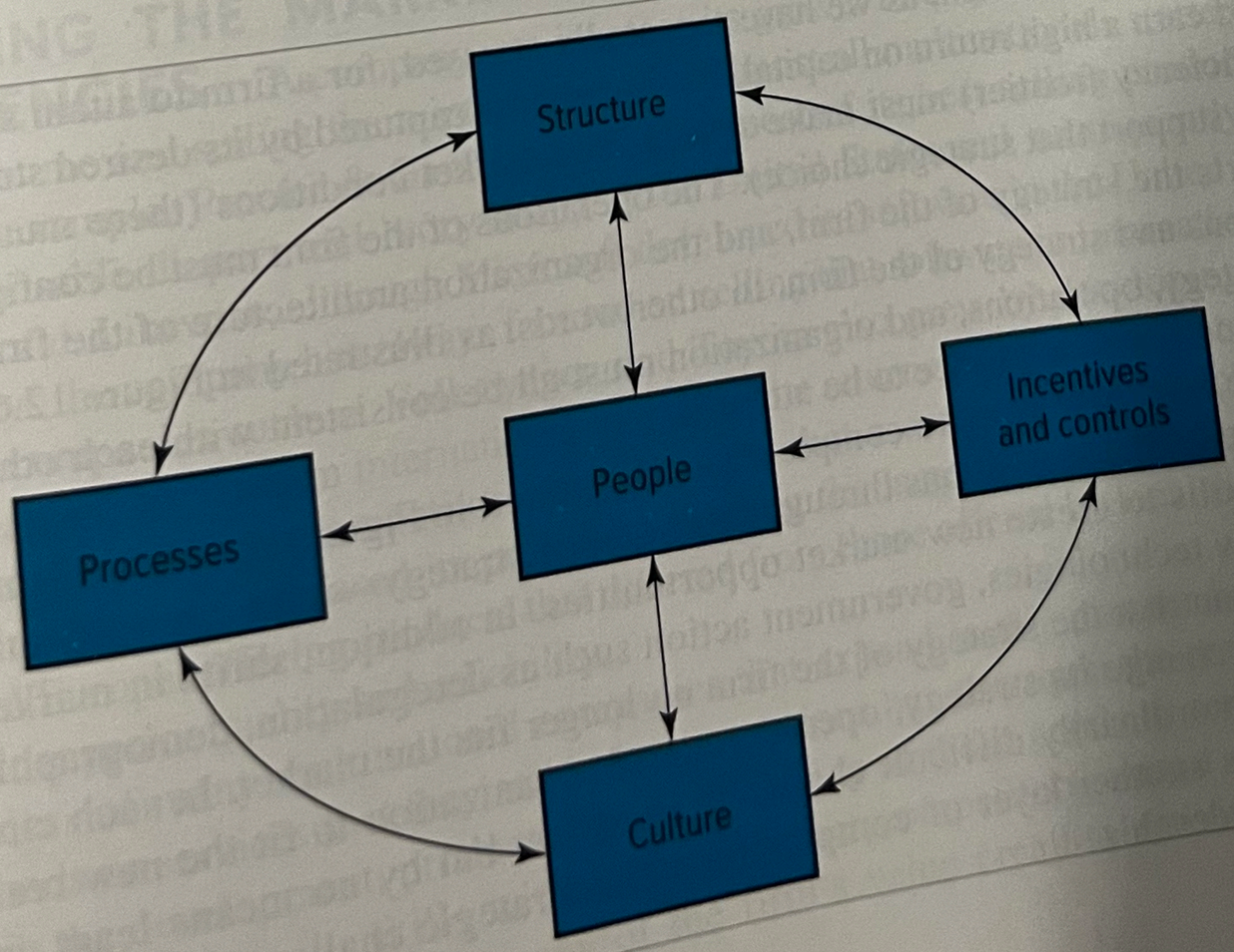
The concept of a value chain can be used to examine the role your education plays in your life plans, if you look closely at your personal development plans (education, internship, work, physical and emotional fitness, and extracurricular activities) and think about them in terms of primary and support activities. If we use the logic that the amount of value you receive from your education is the difference between the costs (e.g., tuition, time, lost income) and what you receive in the form of education (e.g., knowledge, tools, networks), how does your choice of major area of focus in your education fit into your personal development strategy? How do your choices of how you spend your time fit into your value chain? Do you ever spend time doing things that do not support the strategic goals of your personal value chain? But, most importantly, what is the one thing you should do more of to drive the value higher for yourself today and in the future?

Organization: The Implementation of Strategy

The strategy of a firm is implemented through its organization. For a firm to have superior return on invested capital (ROIC), its organization must support its strategy and operations. The term **organization architecture** can be used to refer to the totality of a firm's organization, including formal organizational structure, control systems and incentives, organizational culture, processes, and people.[14] Figure 12.5 illustrates these different elements. By **organizational structure**, we

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

organizational structure
The three-part structure of an organization, including its formal division into subunits such as product divisions, its location of decision-making responsibilities within that structure, and the establishment of integrating mechanisms to coordinate the activities of all subunits.



12.5 FIGURE
Organization architecture.

mean three things: first, the formal division of the organization into subunits such as product divisions, national operations, and functions (most organizational charts display this aspect of structure); second, the location of decision-making responsibilities within that structure (e.g., centralized or decentralized); and third, the establishment of integrating mechanisms to coordinate the activities of subunits including cross-functional teams and or pan-regional committees.

controls
The metrics used to measure the performance of subunits and make judgments about how well managers are running those subunits.

Controls are the metrics used to measure the performance of subunits and make judgments about how well managers are running those subunits. **Incentives** are the devices used to reward appropriate managerial behavior. Incentives are very closely tied to performance metrics. For example, the incentives of a manager in charge of a national operating subsidiary might be linked to the performance of that company. Specifically, she might receive a bonus if her subsidiary exceeds its performance targets.

incentives
The devices used to reward appropriate managerial behavior.

processes
The manner in which decisions are made and work is performed within any organization.

Processes are the manner in which decisions are made and work is performed within the organization. Examples are the processes for formulating strategy, for deciding how to allocate resources within a firm, or for evaluating the performance of managers and giving feedback. Processes are conceptually distinct from the location of decision-making responsibilities within an organization, although both involve decisions. While the CEO might have ultimate responsibility for deciding what the strategy of the firm should be (i.e., the decision-making responsibility is centralized), the process he or she uses to make that decision might include the solicitation of ideas and criticism from lower-level managers.

organizational culture
The values and norms shared among an organization's employees.

Organizational culture is the norms and value systems that are shared among the employees of an organization. Just as societies have cultures (see Chapter 4 for details), so do organizations. Organizations are societies of individuals who come together to perform collective tasks. They have their own distinctive patterns of culture and subculture.[15] As we shall see, organizational culture can have a profound impact on how a firm performs. Finally, by **people** we mean not just the employees of the organization but also the strategy used to recruit, compensate, and retain those individuals and the type of people that they are in terms of their skills, values, and orientation (discussed in depth in Chapter 17).

people
The employees of the organization, the strategy used to recruit, compensate, and retain those individuals, and the type of people that they are in terms of their skills, values, and orientation.

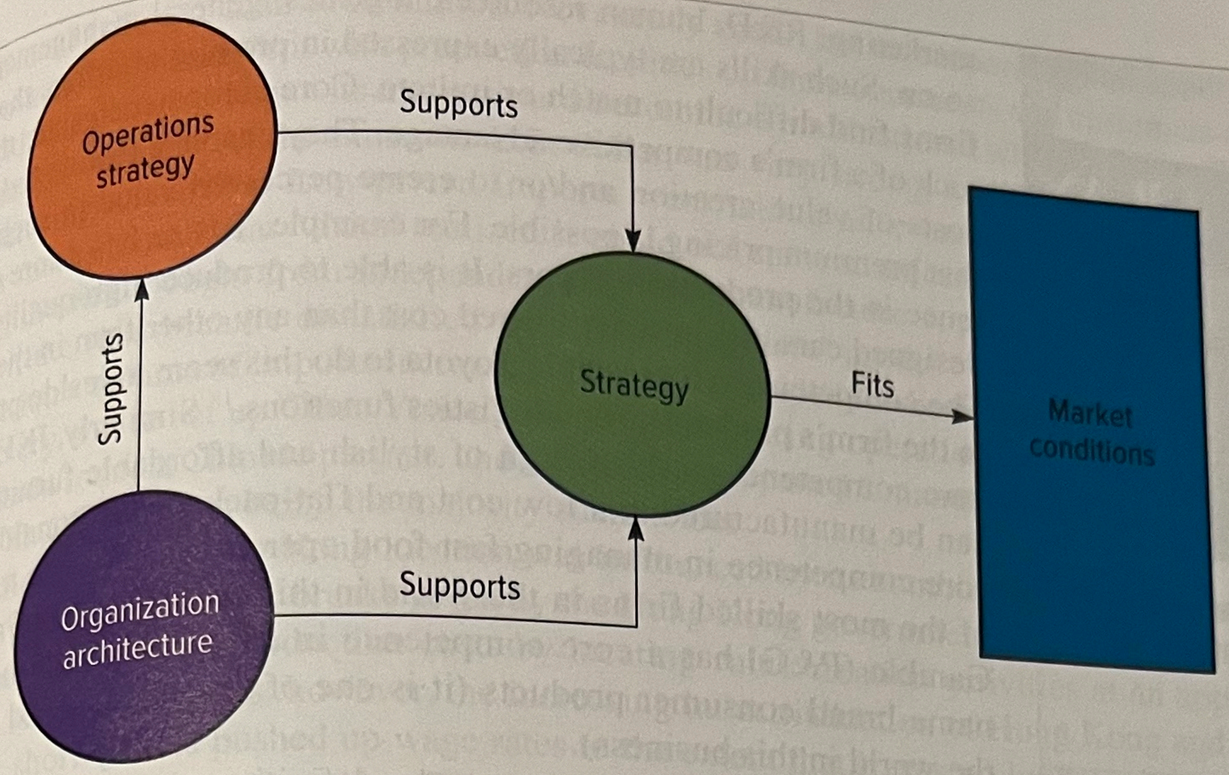
As illustrated by the arrows in Figure 12.5, the various components of an organization's architecture are not independent of each other: Each component shapes, and is shaped by, other components of architecture. An obvious example is the strategy regarding people. This can be used proactively to hire individuals whose internal values are consistent with those that the firm wishes to emphasize in its organization culture. Thus, the people component of architecture can be used to reinforce (or not) the prevailing culture of the organization. If a firm is going to maximize its profitability, it must pay close attention to achieving internal consistency among the various components of its architecture, and the architecture must support the strategy and operations of the firm.

Strategic Fit

In sum, as we have repeatedly stressed, for a firm to attain superior performance and earn a high return on capital, its strategy (as captured by its desired strategic position on the efficiency frontier) must make sense given market conditions (there must be sufficient demand to support that strategic choice). The operations of the firm must be configured in a way that supports the strategy of the firm, and the organization architecture of the firm must match the operations and strategy of the firm. In other words, as illustrated in Figure 12.6, market conditions, strategy, operations, and organization must all be consistent with each other, or fit each other, for superior performance to be attained.

Of course, the issue is more complex than illustrated in Figure 12.6. For example, the firm can influence market conditions through its choice of strategy—it can create demand by leveraging core skills to create new market opportunities. In addition, shifts in market conditions caused by new technologies, government action such as deregulation, demographics, or social trends can mean that the strategy of the firm no longer fits the market. In such circumstances, the firm must change its strategy, operations, and organization to fit the new reality—which can be an extraordinarily difficult challenge. And last but by no means least, international expansion adds another layer of complexity to the strategic challenges facing the firm. We shall now consider this.

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12.6 FIGURE
Strategic fit.

Global Expansion, Profitability, and Profit Growth

LO 12-2
Recognize how firms can increase revenue and profit by expanding globally.

Expanding globally allows firms to increase their profitability and rate of profit growth in ways not available to purely domestic enterprises.[16] Firms that operate internationally are able to

1. Expand the market for their domestic product offerings by selling those products in international markets.
2. Realize location economies by dispersing individual value creation activities to those locations around the globe where they can be performed most efficiently and effectively.
3. Realize greater cost economies from experience effects by serving an expanded global market from a central location, thereby reducing the costs of value creation.
4. Earn a greater return by leveraging any valuable skills developed in foreign operations and transferring them to other entities within the firm's global network of operations.

As we will see, however, a firm's ability to increase its profitability and profit growth by pursuing these strategies is constrained by the need to customize its product offering, marketing strategy, and business strategy to differing national or regional conditions—that is, by the imperative of localization.

EXPANDING THE MARKET: LEVERAGING PRODUCTS AND COMPETENCIES

A company can increase its growth rate by taking goods or services developed at home and selling them internationally. Almost all multinationals started out doing just this. For example, Procter & Gamble developed most of its best-selling products (such as Pampers disposable diapers and Ivory soap) in the United States and subsequently sold them around the world. Likewise, although Microsoft developed its software in the United States, from its earliest days the company has always focused on selling that software in international markets. Automobile companies such as Volkswagen and Toyota also grew by developing products at home and then selling them in international markets. The returns from such a strategy are likely to be greater if indigenous competitors in the nations that a company enters lack comparable products. Thus, Toyota increased its profits by entering the large automobile markets of North America and Europe, offering products that differed from those offered by local rivals (Ford and GM) in their superior quality and reliability.

The success of many multinational companies that expand in this manner is based not just upon the goods or services that they sell in foreign nations but also upon the core competencies that underlie the development, production, and marketing of those goods or services. The term **core competence** refers to skills within the firm that competitors cannot easily match or imitate.[17] These skills may exist in any of the firm's value creation activities: production,

core competence
Firm skills that competitors cannot easily match or imitate.



P&G's core competency in marketing is evidenced in this photo of Olay men's skin care products for sale in a Shanghai, China, supermarket.

©Weng lei/Imaginechina/AP Images

marketing, R&D, human resources, logistics, general management, and so on. Such skills are typically expressed in product offerings that other firms find difficult to match or imitate. Core competencies are the bedrock of a firm's competitive advantage. They enable a firm to reduce the costs of value creation and/or to create perceived value in such a way that premium pricing is possible. For example, Toyota has a core competence in the production of cars. It is able to produce high-quality, well-designed cars at a lower delivered cost than any other firm in the world. The competencies that enable Toyota to do this seem to reside primarily in the firm's production and logistics functions.[18] Similarly, IKEA has a core competence in the design of stylish and affordable furniture that can be manufactured at a low cost and flat-packed, McDonald's has a core competence in managing fast-food operations (it seems to be one of the most skilled firms in the world in this industry), and Procter & Gamble (P&G) has a core competence in developing and marketing name-brand consumer products (it is one of the most skilled firms in the world in this business).

Because core competencies are, by definition, the source of a firm's competitive advantage, the successful global expansion by manufacturing companies such as Toyota and P&G was based not just on leveraging products and selling them in foreign markets but also on the transfer of core competencies to foreign markets in which indigenous competitors lacked them. The same can be said of companies engaged in the service sectors of an economy, such as financial institutions, retailers, restaurant chains, and hotels. Expanding the market for their services often means replicating their business model in foreign nations (albeit with some changes to account for local differences, which we will discuss in more detail shortly). Firms such as Starbucks and IKEA, for example, expanded rapidly outside of their home markets in the United States by taking the basic business model that they developed at home and using that as a blueprint for establishing international operations.

LOCATION ECONOMIES

Earlier chapters revealed that countries differ along a range of dimensions—including the economic, political, legal, and cultural—and that these differences can either raise or lower the costs of doing business in a country. The theory of international trade also teaches that due to differences in factor costs, certain countries have a comparative advantage in the production of certain products. Japan might excel in the production of automobiles and consumer electronics; the United States in the production of computer software, pharmaceuticals, biotechnology products, and financial services; Switzerland in the production of precision instruments and pharmaceuticals; South Korea in the production of semiconductors; and Vietnam in the production of apparel.[19]

For a firm that is trying to survive in a competitive global market, this implies that *trade barriers and transportation costs* permitting, the firm will benefit by basing each value creation activity it performs at that location where economic, political, and cultural conditions—including relative factor costs—are most conducive to the performance of that activity. Thus, if the best designers for a product live in France, a firm should base its design operations in France. If the most productive labor force for assembly operations is in Mexico, assembly operations should be based in Mexico. If the best marketers are in the United States, the marketing strategy should be formulated in the United States. And so on.

ocation economies
ost advantages from performing value creation activity at the otimal location for that activity.

Firms that pursue such a strategy can realize what we refer to as **location economies**, which are the economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be (transportation costs and trade barriers permitting). Locating a value creation activity in the optimal location for that activity can have one of two effects. *It can lower the costs of value creation and help the firm to achieve a low-cost position, and/or it can enable a firm to differentiate its product offering from those of competitors.* In terms of Figure 12.2, it can lower *C* and/or increase *V* (which, in general, supports higher pricing), both of which boost the profitability of the enterprise.

For an example of how this works in an international business, consider Clear Vision, a manufacturer and distributor of eyewear. Started by David Glassman, the firm now generates annual

gross revenues of more than $100 million. Not exactly small, but no corporate giant either, Clear Vision is a multinational firm with production facilities on three continents and customers around the world. Clear Vision began its move toward becoming a multinational when its sales were still less than $20 million. At the time, the U.S. dollar was very strong, and this made U.S.-based manufacturing expensive. Low-priced imports were taking an ever-larger share of the U.S. eyewear market, and Clear Vision realized it could not survive unless it also began to import. Initially, the firm bought from independent overseas manufacturers, primarily in Hong Kong. However, the firm became dissatisfied with these suppliers' product quality and delivery. As Clear Vision's volume of imports increased, Glassman decided the best way to guarantee quality and delivery was to set up Clear Vision's own manufacturing operation overseas. Accordingly, Clear Vision found a Chinese partner, and together they opened a manufacturing facility in Hong Kong, with Clear Vision being the majority shareholder.

The choice of the Hong Kong location was influenced by its combination of low labor costs, a skilled workforce, and tax breaks given by the Hong Kong government. The firm's objective at this point was to lower production costs by locating value creation activities at an appropriate location. After a few years, however, the increasing industrialization of Hong Kong and a growing labor shortage had pushed up wage rates to the extent that it was no longer a low-cost location. In response, Glassman and his Chinese partner moved part of their manufacturing to a plant in mainland China to take advantage of the lower wage rates there. Again, the goal was to lower production costs. The parts for eyewear frames manufactured at this plant are shipped to the Hong Kong factory for final assembly and then distributed to markets in North and South America. The Hong Kong factory employs 80 people and the China plant between 300 and 400.

At the same time, Clear Vision was looking for opportunities to invest in foreign eyewear firms with reputations for fashionable design and high quality. Its objective was not to reduce production costs but to launch a line of high-quality, differentiated, "designer" eyewear. Clear Vision did not have the design capability in-house to support such a line, but Glassman knew that certain foreign manufacturers did. As a result, Clear Vision invested in factories in Japan, France, and Italy, holding a minority shareholding in each case. These factories now supply eyewear for Clear Vision's Status Eye division, which markets high-priced designer eyewear.[20]

Thus, to deal with a threat from foreign competition, Clear Vision adopted a strategy intended to lower its cost structure (lower *C*): shifting its production from a high-cost location, the United States, to a low-cost location, first Hong Kong and later China. Then Clear Vision adopted a strategy intended to increase the perceived value of its product (increase *V*) so it could charge a premium price (*P*). Reasoning that premium pricing in eyewear depended on superior design, its strategy involved investing capital in French, Italian, and Japanese factories that had reputations for superior design. In sum, Clear Vision's strategies included some actions intended to reduce its costs of creating value and other actions intended to add perceived value to its product through differentiation. The overall goal was to increase the value created by Clear Vision and thus the profitability of the enterprise. To the extent that these strategies were successful, the firm should have attained a higher profit margin and greater profitability than if it had remained a U.S.-based manufacturer of eyewear.

Creating a Global Web

Generalizing from the Clear Vision example, one result of this kind of thinking is the creation of a **global web** of value creation activities, with different stages of the value chain being dispersed to those locations around the globe where perceived value is maximized or where the costs of value creation are minimized.[21] Consider Lenovo's ThinkPad laptop computers (Lenovo is the Chinese computer company that purchased IBM's personal computer operations).[22] This product is designed in the United States by engineers because Lenovo believes that the United States is the best location in the world to do the basic design work. The case, keyboard, and hard drive are made in Thailand; the display screen and memory in South Korea; the built-in wireless card in Malaysia; and the microprocessor in the United States. In each case, these components are manufactured and sourced from the optimal location given current factor costs. These components are then shipped to an assembly operation in China, where the product is assembled before being shipped to the United States for final sale. Lenovo assembles the ThinkPad in Mexico because managers have calculated that due to low labor costs, the costs of assembly can be minimized there. The marketing and sales strategy for

global web
When different stages of value chain are dispersed to those locations around the globe where value added is maximized or where costs of value creation are minimized.

North America is developed by Lenovo personnel in the United States, primarily because managers believe that due to their knowledge of the local marketplace, U.S. personnel add more value to the product through their marketing efforts than personnel based elsewhere.

In theory, a firm that realizes location economies by dispersing each of its value creation activities to its optimal location should have a competitive advantage vis-à-vis a firm that bases all of its value creation activities at a single location. It should be able to better differentiate its product offering (thereby raising perceived value, *V*) and lower its cost structure (*C*) than its single-location competitor. In a world where competitive pressures are increasing, such a strategy may become an imperative for survival.

Some Caveats

Introducing transportation costs and trade barriers complicates this picture. Due to favorable factor endowments, New Zealand may have a comparative advantage for automobile assembly operations, but high transportation costs would make it an uneconomical location from which to serve global markets. Another caveat concerns the importance of assessing political and economic risks when making location decisions. Even if a country looks very attractive as a production location when measured against all the standard criteria, if its government is unstable or totalitarian, the firm might be advised not to base production there. (Political risk is discussed in Chapter 3.) Similarly, if the government appears to be pursuing inappropriate economic policies that could lead to foreign exchange risk, that might be another reason for not basing production in that location, even if other factors look favorable.

EXPERIENCE EFFECTS

experience curve
Systematic production cost reductions that occur over the life of a product.

The **experience curve** refers to systematic reductions in production costs that have been observed to occur over the life of a product.[23] A number of studies have observed that a product's production costs decline by some quantity about each time *cumulative* output doubles. The relationship was first observed in the aircraft industry, where each time cumulative output of airframes was doubled, unit costs typically declined to 80 percent of their previous level.[24] Thus, production cost for the fourth airframe would be 80 percent of production cost for the second airframe, the eighth airframe's production costs 80 percent of the fourth's, the sixteenth's 80 percent of the eighth's, and so on. Figure 12.7 illustrates this experience curve relationship between unit production costs and *cumulative* output (the relationship is for *cumulative* output over time and *not* output in any one period, such as a year). Two things explain this: learning effects and economies of scale.

Learning Effects

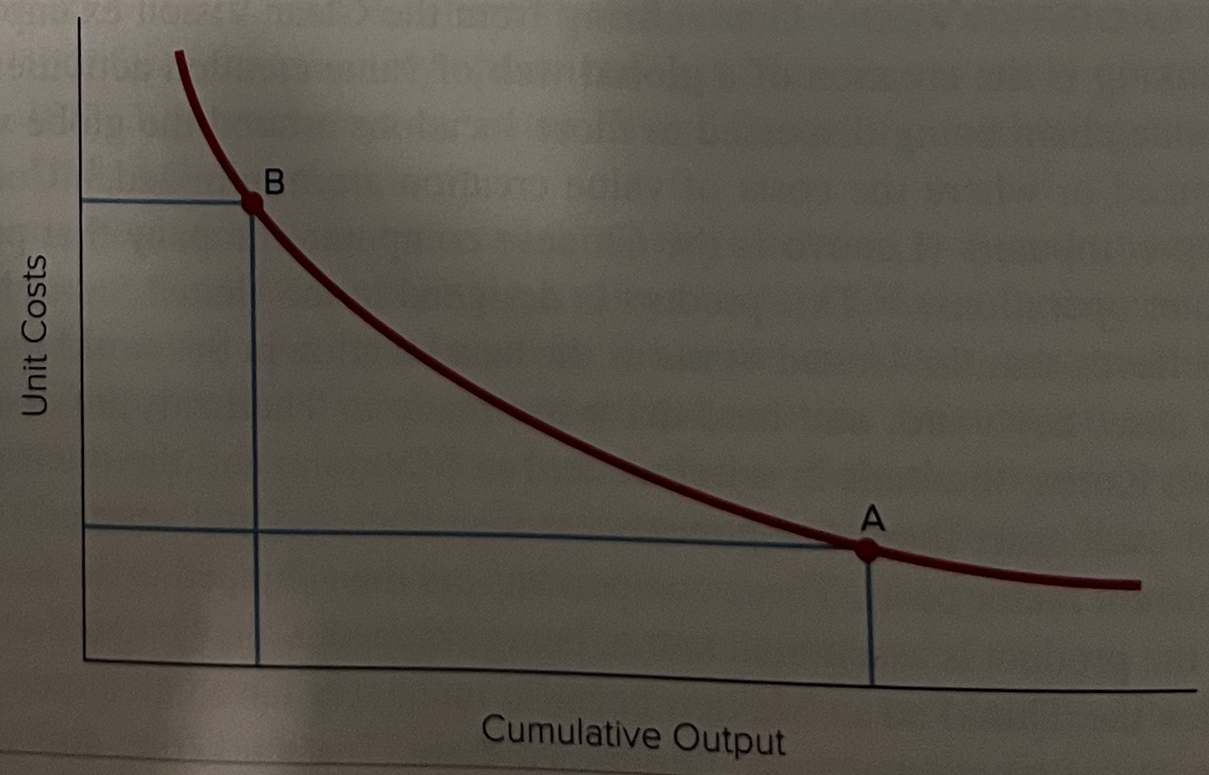
learning effects
Cost savings from learning by doing.

Learning effects refer to cost savings that come from learning by doing. Labor, for example, learns by repetition how to carry out a task, such as assembling airframes, most efficiently. Labor productivity increases over time as individuals learn the most efficient ways to perform particular tasks. Equally important in new production facilities, management typically learns how to manage the new operation more efficiently over time. Hence, production costs decline due to increasing labor productivity and management efficiency, which increases the firm's profitability.

12.7 FIGURE

The experience curve.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).



Learning effects tend to be more significant when a technologically complex task is repeated because there is more that can be learned about the task. Thus, learning effects will be more significant in an assembly process involving 1,000 complex steps than in one of only 100 simple steps. No matter how complex the task, however, learning effects typically disappear after a while. It has been suggested that they are important only during the start-up period of a new process and that they cease after two or three years.[25] Any decline in the experience curve after such a point is due to economies of scale.

Economies of Scale

Economies of scale refer to the reductions in unit cost achieved by producing a large volume of a product. Attaining economies of scale lowers a firm's unit costs and increases its profitability. Economies of scale have a number of sources. One is the ability to spread fixed costs over a large volume.[26] Fixed costs are the costs required to set up a production facility, develop a new product, and the like. They can be substantial. For example, the fixed cost of establishing a new production line to manufacture semiconductor chips now exceeds $5 billion. Similarly, according to one estimate, developing a new drug and bringing it to market costs about $800 million and takes about 12 years.[27] The only way to recoup such high fixed costs may be to sell the product worldwide, which reduces average unit costs by spreading fixed costs over a larger volume. The more rapidly that cumulative sales volume is built up, the more rapidly fixed costs can be amortized over a large production volume and the more rapidly unit costs will fall.

economies of scale
Cost advantages associated with large-scale production.

Second, a firm may not be able to attain an efficient scale of production unless it serves global markets. In the automobile industry, for example, an efficiently scaled factory is one designed to produce about 200,000 units a year. Automobile firms would prefer to produce a single model from each factory because this eliminates the costs associated with switching production from one model to another. If domestic demand for a particular model is only 100,000 units a year, the inability to attain a 200,000-unit output will drive up average unit costs. By serving international markets as well, however, the firm may be able to push production volume up to 200,000 units a year, thereby reaping greater scale economies, lowering unit costs, and boosting profitability. By serving domestic and international markets from its production facilities, a firm may be able to utilize those facilities more intensively. For example, if Intel sold microprocessors only in the United States, it might be able to keep its factories open for only one shift five days a week. By serving international markets from the same factories, Intel can utilize its productive assets more intensively, which translates into higher capital productivity and greater profitability.

Finally, as global sales increase the size of the enterprise, its bargaining power with suppliers increases as well, which may allow it to attain economies of scale in purchasing, bargaining down the cost of key inputs and boosting profitability that way. For example, Walmart has used its enormous sales volume as a lever to bargain down the price it pays suppliers for merchandise sold through its stores.

Strategic Significance

The strategic significance of the experience curve is clear. Moving down the experience curve allows a firm to reduce its cost of creating value (to lower C in Figure 12.2) and increase its profitability. The firm that moves down the experience curve most rapidly will have a cost advantage vis-á-vis its competitors. Firm A in Figure 12.7, because it is farther down the experience curve, has a clear cost advantage over firm B.

Many of the underlying sources of experience-based cost economies are plant-based. This is true for most learning effects as well as for the economies of scale derived by spreading the fixed costs of building productive capacity over a large output, attaining an efficient scale of output, and utilizing a plant more intensively. Thus, one key to progressing downward on the experience curve as rapidly as possible is to increase the volume produced by a single plant as rapidly as possible. Because global markets are larger than domestic markets, a firm that serves a global market from a single location is likely to build accumulated volume more quickly than a firm that serves only its home market or that serves multiple markets from multiple production locations. Thus, serving a global market from a single location is consistent with moving down the experience curve and establishing a low-cost position. In addition, to get down the experience curve rapidly, a firm may need to price and market aggressively so demand will expand rapidly. It will also need to build sufficient production capacity for serving a global market. Also, the cost advantages of serving the world market from a single location will be even more significant if that location is the optimal one for performing the particular value creation activity.

Once a firm has established a low-cost position, it can act as a barrier to new competition. Specifically, an established firm that is well down the experience curve, such as firm A in Figure 12.7, can price so that it is still making a profit while new entrants, which are farther up the curve, are suffering losses. Intel is one of the masters of this kind of strategy. The costs of building a state-of-the-art facility to manufacture microprocessors are so large (now around $5 billion) that to make this investment pay Intel *must* pursue experience curve effects, serving world markets from a limited number of plants to maximize the cost economies that derive from scale and learning effects.

LEVERAGING SUBSIDIARY SKILLS Implicit in our earlier discussion of core competencies is the idea that valuable skills are developed first at home and then transferred to foreign operations. However, for more mature multinationals that have already established a network of subsidiary operations in foreign markets, the development of valuable skills can just as well occur in foreign subsidiaries.[28] Skills can be created anywhere within a multinational's global network of operations, wherever people have the opportunity and incentive to try new ways of doing things. The creation of skills that help to lower the costs of production or to enhance perceived value and support higher product pricing is not the monopoly of the corporate center.

Leveraging the skills created within subsidiaries and applying them to other operations within the firm's global network may create value. McDonald's is increasingly finding that its foreign franchisees are a source of valuable new ideas. Faced with slow growth in France, its local franchisees began to experiment not only with the menu but also with the layout and theme of restaurants. Gone are the ubiquitous golden arches; gone too are many of the utilitarian chairs and tables and other plastic features of the fast-food giant. Many McDonald's restaurants in France now have hardwood floors, exposed brick walls, and even armchairs. The menu, too, has been changed to include premier sandwiches, such as chicken on focaccia bread, priced some 30 percent higher than the average hamburger. In France at least, the strategy seems to be working. Following the change, increases in same-store sales rose from 1 percent annually to 3.4 percent, and France is now the second-largest national market for McDonald's. Impressed with the impact, McDonald's executives are considering similar changes at other McDonald's restaurants in markets where same-store sales growth is sluggish, including the United States.[29]

For the managers of the multinational enterprise, this phenomenon creates important new challenges. First, they must have the humility to recognize that valuable skills that lead to competencies can arise anywhere within the firm's global network, not just at the corporate center. Second, they must establish an incentive system that encourages local employees to acquire new skills. This is not as easy as it sounds. Creating new skills involves a degree of risk. Not all new skills add value. For every valuable idea created by a McDonald's subsidiary in a foreign country, there may be several failures. The management of the multinational must install incentives that encourage employees to take the necessary risks. The company must reward people for successes and not sanction them unnecessarily for taking risks that did not pan out. Third, managers must have a process for identifying when valuable new skills have been created in a subsidiary. And finally, they need to act as facilitators, helping to transfer valuable skills within the firm.

PROFITABILITY AND PROFIT GROWTH SUMMARY We have seen how firms that expand globally can increase their profitability and profit growth by entering new markets where indigenous competitors lack similar competencies, by lowering costs and adding value to their product offering through the attainment of location economies, by exploiting experience curve effects, and by transferring valuable skills among their global network of subsidiaries. For completeness, it should be noted that strategies that increase profitability may also expand a firm's business and thus enable it to attain a higher rate of profit growth. For example, by simultaneously realizing location economies and experience effects, a firm may be able to produce a more highly valued product at a lower unit cost, thereby boosting profitability. The increase in the perceived value of the product may also attract more customers, thereby growing revenues and profits as well. Furthermore, rather than raising prices to reflect the higher perceived value of the product, the firm's managers may elect to hold prices low in order to increase global market share and attain greater scale economies (in other words, they may elect to offer

consumers better "value for money"). Such a strategy could increase the firm's rate of profit growth even further, because consumers will be attracted by prices that are low relative to value. The strategy might also increase profitability if the scale economies that result from market share gains are substantial. In sum, managers need to keep in mind the complex relationship between profitability and profit growth when making strategic decisions about pricing.

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Cost Pressures and Pressures for Local Responsiveness

LO 12-3

Understand how pressures for cost reductions and local responsiveness influence strategic choice.

Firms that compete in the global marketplace typically face two types of competitive pressure that affect their ability to realize location economies and experience effects and to leverage products and transfer competencies and skills within the enterprise. They face *pressures for cost reductions* and *pressures to be locally responsive* (see Figure 12.8).[30] These competitive pressures place conflicting demands on a firm. Responding to pressures for cost reductions requires that a firm try to minimize its unit costs. But responding to pressures to be locally responsive requires that a firm differentiate its product offering and marketing strategy from country to country (or in some cases, region to region) in an effort to accommodate the diverse demands arising from national (or regional) differences in consumer tastes and preferences, business practices, distribution channels, competitive conditions, and government policies. Because differentiation across countries can involve significant duplication and a lack of product standardization, it may raise costs.

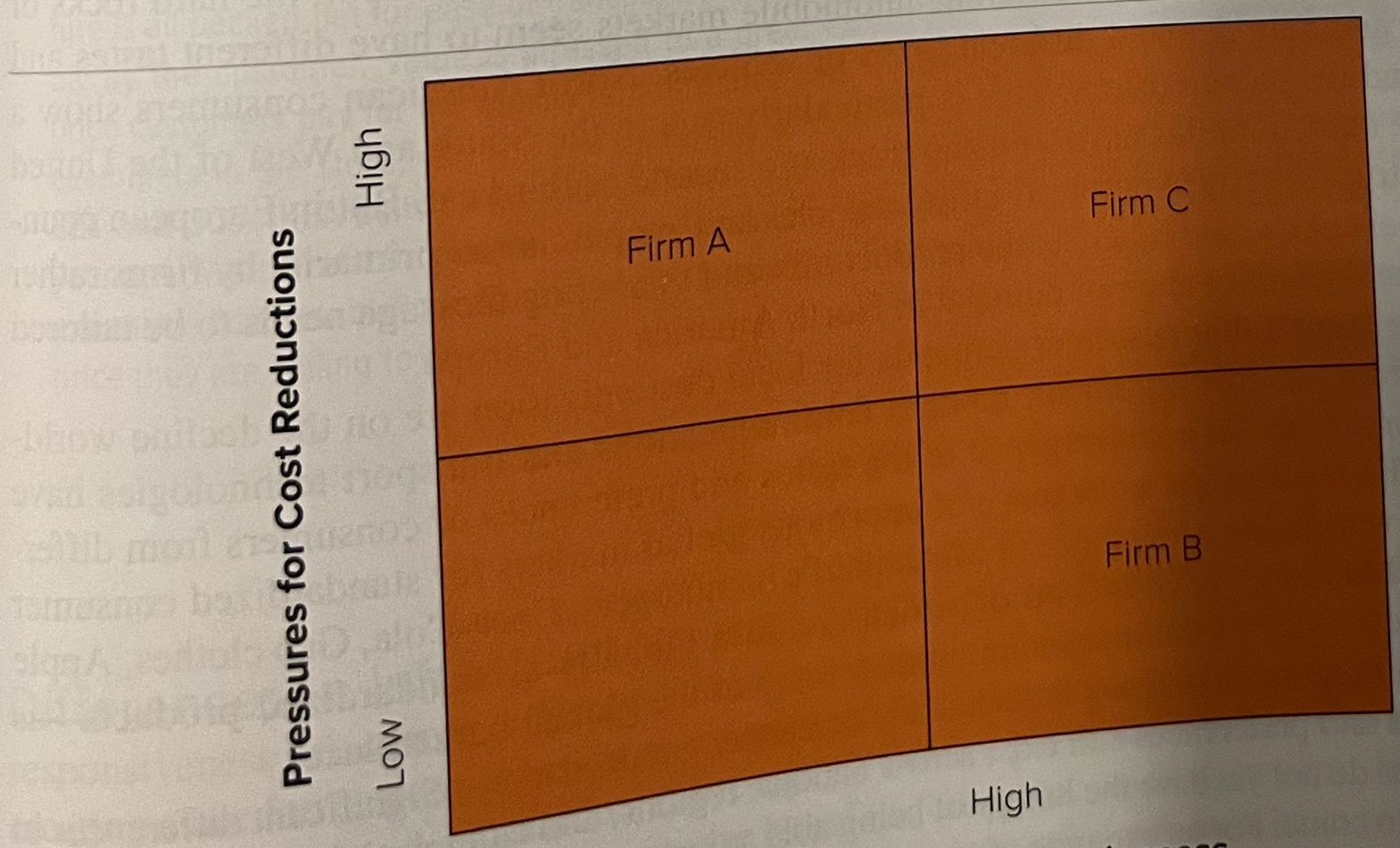
While some enterprises, such as firm A in Figure 12.8, face high pressures for cost reductions and low pressures for local responsiveness, and others, such as firm B, face low pressures for cost reductions and high pressures for local responsiveness, many companies are in the position of firm C. They face high pressures for *both* cost reductions and local responsiveness. Dealing with these conflicting and contradictory pressures is a difficult strategic challenge, primarily because being locally responsive tends to raise costs.

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PRESSURES FOR COST REDUCTIONS

In competitive global markets, international businesses often face pressures for cost reductions. Responding to pressures for cost reduction requires a firm to try to lower the costs of value creation. A manufacturer, for example, might mass-produce a standardized product at the optimal locations in the world, wherever that might be, to realize economies of scale, learning effects, and location economies. Alternatively, a firm might outsource certain functions to low-cost foreign suppliers in an attempt to reduce costs. Thus, many computer companies have outsourced their telephone-based customer service functions to India, where qualified technicians who speak English can be hired for a lower wage



12.8 FIGURE

Pressures for cost reductions and local responsiveness.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).

rate than in the United States. In the same manner, a retailer such as Walmart might push its suppliers (manufacturers) to do the same. (The pressure that Walmart has placed on its suppliers to reduce prices has been cited as a major cause of the trend among North American manufacturers to shift production to China.[31]) A service business such as a bank might respond to cost pressures by moving some back-office functions, such as information processing, to developing nations where wage rates are lower.

Pressures for cost reduction can be particularly intense in industries producing commodity-type products where meaningful differentiation on nonprice factors is difficult and price is the main competitive weapon. This tends to be the case for products that serve universal needs. **Universal needs** exist when the tastes and preferences of consumers in different nations or regions are similar, if not identical. This is the case for conventional commodity products such as bulk chemicals, petroleum, steel, sugar, and the like. It also tends to be the case for many industrial and consumer products—for example, smartphones, semiconductor chips, personal computers, and liquid crystal display screens. Pressures for cost reductions are also intense in industries where major competitors are based in low-cost locations, where there is persistent excess capacity, and where consumers are powerful and face low switching costs. The liberalization of the world trade and investment environment in recent decades, by facilitating greater international competition, has generally increased cost pressures.[32]

universal needs
Needs that are the same all over the world, such as steel, bulk chemicals, and industrial electronics.

PRESSURES FOR LOCAL RESPONSIVENESS

Pressures for local responsiveness arise from national or regional differences in consumer tastes and preferences, infrastructure, accepted business practices, and distribution channels and from host-government demands. Responding to pressures to be locally responsive requires a firm to differentiate its products and marketing strategy from country to country or region to region to accommodate these factors—all of which tends to raise the firm's cost structure.

Differences in Customer Tastes and Preferences

Strong pressures for local responsiveness emerge when customer tastes and preferences differ significantly among countries, as they often do for deeply embedded historic or cultural reasons. In such cases, a multinational's products and marketing message have to be customized to appeal to the tastes and preferences of local customers. This typically creates pressure to delegate production and marketing responsibilities and functions to a firm's overseas subsidiaries.

For example, the automobile industry in the 1990s moved toward the creation of "world cars." The idea was that global companies such as General Motors, Ford, and Toyota would be able to sell the same basic vehicle the world over, sourcing it from centralized production locations. If successful, the strategy would have enabled automobile companies to reap significant gains from global scale economies. However, this strategy frequently ran aground upon the hard rocks of consumer reality. Consumers in different automobile markets seem to have different tastes and preferences, and they demand different types of vehicles. North American consumers show a strong demand for pickup trucks. This is particularly true in the South and West of the United States, where many families have a pickup truck as a second or third car. But in European countries, pickup trucks are seen purely as utility vehicles and are purchased primarily by firms rather than individuals. As a consequence, the product mix and marketing message needs to be tailored to consider the different nature of demand in North America and Europe.

Some have argued that customer demands for local customization are on the decline worldwide.[33] According to this argument, modern communications and transport technologies have created the conditions for a convergence of the tastes and preferences of consumers from different nations. The result is the emergence of enormous global markets for standardized consumer products. The worldwide acceptance of McDonald's hamburgers, Coca-Cola, Gap clothes, Apple iPhones, and Microsoft's Xbox—all of which are sold globally as standardized products—is often cited as evidence of the increasing homogeneity of the global marketplace.

However, this argument may not hold in many consumer goods markets. Significant differences in consumer tastes and preferences still exist across nations, regions, and cultures. Managers in international businesses do not yet have the luxury of being able to ignore these differences, and they may not for a long time to come. For an example of a company that has discovered how important pressures on cost reductions can be, read the accompanying Management Focus on IKEA's global strategy.

management FOCUS

IKEA's Global Strategy

Walk into an IKEA store anywhere in the world, and you would recognize it instantly. Global strategy standardization is rampant! The warehouse-type stores all sell the same broad range of affordable home furnishings, kitchens, accessories, and food. Most of the products are instantly recognizable as IKEA merchandise, with their clean yet tasteful lines and functional design. With a heritage from Sweden (IKEA was founded in 1943 as a mail order company, and the first store opened in Sweden in 1958), the outside of the store is wrapped in the blue and yellow colors of the Swedish flag. IKEA has sales of €34.2 billion annually (about 37 billion U.S. dollars) and more than 150,000 employees. Interestingly, IKEA is responsible for about 1 percent of the world's commercial-product wood consumption.

The IKEA name comes from its founder—the acronym consists of the founder's initials from his first and last names (Ingvar Kamprad) along with the first initials of the farm where he grew up (Elmtaryd) and his hometown in Sweden (Agunnaryd). Overall, Sweden has 20 IKEA stores, which is only fewer than in Germany (49 IKEA stores), the United States (42), France (32), and Italy (21). Spain also has 20 stores. The largest IKEA store is in Gwangmyeong, South Korea, at some 640,000 square feet. With 351 stores in 46 countries, IKEA is the largest furniture retailer in the world. Basically, the furniture market is one of the least global markets, with local tastes, needs, and interests much different than for many other products across industries.

The IKEA store itself is laid out as a maze that requires customers to walk through every department before they reach the checkout stations. The stores are often structured as a one-way layout, leading customers counterclockwise along what IKEA calls "the long natural way." This "way" is designed to encourage customers to see the store in its entirety. Cut-off points and shortcuts exist but are not easy to figure out. It is even difficult to get back out after having a meal in the famous IKEA restaurant with its Swedish food (meatballs anyone?).

Immediately before the checkout, there is an in-store warehouse where customers can pick up the items they purchased. The furniture is all packed flat for ease of transportation and requires assembly by the customer. Value is stressed to a great extent (i.e., the price customers pay for the quality furniture they get). If you look at customers in the store, you will see that many of them are in their 20s and 30s. IKEA sells to the same basic customers worldwide: young, upwardly mobile people who are looking for tasteful yet inexpensive "disposable" furniture of a certain quality standard for the price they are willing to pay.

A global network of more than 1,000 suppliers based in more than 50 countries manufactures most of the 12,000 or so products that IKEA sells. IKEA itself focuses on the design of products and works closely with suppliers to bring down manufacturing costs. Developing a new product line can be a painstaking process that takes years. IKEA's designers will develop a prototype design (e.g., a small couch), look at the price that rivals charge for a similar piece, and then work with suppliers to figure out a way to cut prices by 40 percent without compromising on quality. IKEA also manufactures about 10 percent of what it sells in-house and uses the knowledge gained to help its suppliers improve their productivity, thereby lowering costs across the entire supply chain.

Look a little closer, however, and you will see subtle differences among the IKEA offerings in North America, Europe, and China. In North America, sizes are different to reflect the American demand for bigger beds, furnishings, and kitchenware. This adaptation to local tastes and preferences was the result of a painful learning experience for IKEA. When the company first entered the United States in the late 1980s, it thought that consumers would flock to its stores the same way that they had in Western Europe. At first they did, but they didn't buy as much, and sales fell short of expectations. IKEA discovered that its European-style sofas were not big enough, wardrobe drawers were not deep enough, glasses were too small, and kitchens didn't fit U.S. appliances. So the company set about redesigning its offerings to better match American tastes and was rewarded with accelerated sales growth.

Lesson learned. When IKEA entered China in the 2000s, it made adaptations to the local market. The store layout reflects the layout of many Chinese apartments, where most people live, and because many Chinese apartments have balconies, IKEA's Chinese stores include a balcony section. IKEA has also had to shift its locations in China, where car ownership lags behind that in Europe and North America. In the West, IKEA stores are located in suburban areas and have lots of parking space. In China, stores are located near public transportation, and IKEA offers a delivery service so that Chinese customers can get their purchases home.

Sources: Lindsey Rupp, "Ikea, Dollar General CEOs Lobby Republicans in Tax Showdown," *Bloomberg Businessweek*, March 7, 2017; D. L. Yohn, "How IKEA Designs Its Brand Success," *Forbes*, June 10, 2015; J. Kane, "The 21 Emotional Stages of Shopping at IKEA, From Optimism to Total Defeat," *The Huffington Post*, May 6, 2015; J. Leland, "How the Disposable Sofa Conquered America," *The New York Times Magazine*, October 5, 2005, p. 45; "The Secret of IKEA's Success," *The Economist*, February 24, 2011; B. Torekull, *Leading by Design: The IKEA Story* (New York: HarperCollins, 1998); and P. M. Miller, "IKEA with Chinese Characteristics," *Chinese Business Review*, July–August 2004, pp. 36–69.

Differences in Infrastructure and Traditional Practices Pressures for local responsiveness arise from differences in infrastructure or traditional practices among countries, creating a need to customize products accordingly. Fulfilling this need may require the delegation of manufacturing and production functions to foreign subsidiaries. For example, in North America, consumer electrical systems are based on 110 volts, whereas in some European countries, 240-volt systems are standard. Thus, domestic electrical appliances have to be customized for this difference in infrastructure. Traditional practices also often vary across nations.

For example, in Britain, people drive on the left-hand side of the road, creating a demand for right-hand-drive cars, whereas in France (and the rest of Europe), people drive on the right-hand side of the road and therefore want left-hand-drive cars. Obviously, automobiles have to be customized to accommodate this difference in traditional practice.

Although many national and regional differences in infrastructure are rooted in history, some are quite recent. For example, in the wireless telecommunications industry, different technical standards exist in different parts of the world. A technical standard known as GSM is common in Europe, and an alternative standard, CDMA, is more common in the United States and Russia. Equipment designed for GSM will not work on a CDMA network and vice versa. Thus, companies in this industry—such as Apple and Samsung—that manufacture smartphones or infrastructure such as switches need to customize their product offering according to the technical standard prevailing in a given country or region. GSM stands for Global System for Mobile Communication, and this is the technology the majority of phones use, given it is the standard system for most of the world.

Differences in Distribution Channels A firm's marketing strategies may have to be responsive to differences in distribution channels among countries, which may necessitate the delegation of marketing functions to national subsidiaries. In the pharmaceutical industry, for example, the British and Japanese distribution systems are radically different from the U.S. system. British and Japanese doctors will not accept or respond favorably to a U.S.-style high-pressure sales force. Thus, pharmaceutical companies have to adopt different marketing practices in Britain and Japan compared with the United States—soft sell versus hard sell. Similarly, Poland, Brazil, and Russia all have similar per capita income on a purchasing power parity basis, but there are big differences in distribution systems across the three countries. In Brazil, supermarkets account for 36 percent of food retailing, in Poland for 18 percent, and in Russia for less than 1 percent.[34] These differences in channels require that companies adapt their own distribution and sales strategies.

Host-Government Demands Economic and political demands imposed by host-country governments may require local responsiveness. For example, pharmaceutical companies are subject to local clinical testing, registration procedures, and pricing restrictions—all of which make it necessary that the manufacturing and marketing of a drug should meet local requirements. Because governments and government agencies control a significant proportion of the health care budget in most countries, they are in a powerful position to demand a high level of local responsiveness.

More generally, threats of protectionism, economic nationalism, and local content rules (which require that a certain percentage of a product should be manufactured locally) dictate that international businesses manufacture locally. For example, consider Bombardier, the Canadian-based manufacturer of railcars, aircraft, jet boats, and snowmobiles. Bombardier has 12 railcar factories across Europe. Critics of the company argue that the 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 business lines. In reply, managers at Bombardier argue that in Europe, informal rules with regard to local content favor people who use local workers. To sell railcars in Germany, they claim, you must manufacture in Germany. The same goes for Belgium, Austria, and France. To try to address its cost structure in Europe, Bombardier has centralized its engineering and purchasing functions, but it has no plans to centralize manufacturing.[35]

The Rise of Regionalism Traditionally, we have tended to think of pressures for local responsiveness as being derived from *national* differences in tastes and preferences, infrastructure, and the like. While this is still often the case, there is also a tendency toward the convergence of tastes, preferences, infrastructure, distribution channels, and host-government demands within a broader *region* that is composed of two or more nations.[36] We tend to see this when there are strong pressures for convergence due to, for example, a shared history and culture or the establishment of a trading block where there are deliberate attempts to harmonize trade policies, infrastructure, regulations, and the like.

The most obvious example of a region is the European Union and particularly the euro zone countries within that trade bloc, where there are institutional forces that are pushing toward convergence (see Chapter 9 for details). The creation of a single EU market—with a single currency, common business regulations, standard infrastructure, and so on—cannot help but result in the reduction of certain national differences among countries within the EU and the creation of one regional rather than several national markets. Indeed, at the economic level at least, that is the explicit intent of the EU.

Another example of regional convergence is North America, which includes the United States, Canada, and, to some extent in some product markets, Mexico. Canada and the United States share history, language, and much of their culture, and both are members of NAFTA. Mexico is clearly different in many regards, but its proximity to the United States, along with its membership in NAFTA, implies that for some product markets (e.g., automobiles), it might be reasonable to consider Mexico as part of a relatively homogenous regional market. We might also talk about the Latin America region, where shared Spanish history, cultural heritage, and language (with the exception of Brazil, which was colonized by the Portuguese) mean that national differences are somewhat moderated. It can also be argued that greater China, which includes the city-states of Hong Kong and Singapore along with Taiwan, is a coherent region, as is much of the Middle East, where a strong Arab culture and shared history may limit national differences. Similarly, Russia and some of the former states of the Soviet Union, such as Belarus and Ukraine, might be considered part of a larger regional market, at least for some products.

Taking a regional perspective is important because it may suggest that localization at the regional rather than the national level is the appropriate strategic response. For example, rather than produce cars for each national market within the Europe or North America, it makes far more sense for car manufacturers to build cars for the European or North American regions. The ability to standardize product offering within a region allows for the attainment of greater scale economies, and hence lower costs, than if each nation had to have its own offering. At the same time, this perspective should not be pushed too far. There are still deep and profound cultural differences among France, Germany, and Italy—all members of the EU—that may in turn require some degree of local customization at the *national* level. Managers must thus make a judgment call about the appropriate level of aggregation, given (1) the product market they are looking at and (2) the nature of national differences and trends for regional convergence. What might make sense for automobiles, for example, might not be appropriate for packaged food products.

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Choosing a Strategy

LO 12-4

Identify the different international strategies for competing and their pros and cons.

Pressures for local responsiveness imply that it may not be possible for a firm to realize the full benefits from economies of scale, learning effects, and location economies. It may not be possible to serve the global marketplace from a single low-cost location, producing a globally standardized product and marketing it worldwide to attain the cost reductions associated with experience effects. The need to customize the product offering to local conditions, whether national or regional, may work against the implementation of such a strategy. For example, as noted, automobile firms have found that Japanese, American, and European consumers demand different kinds of cars, and this necessitates producing products that are customized for regional markets. In response, firms such as Honda, Ford, and Toyota are pursuing a strategy of establishing top-to-bottom design and production facilities in each of these regions so that they can better serve local demands. Although such customization brings benefits, it also limits the ability of a firm to realize significant scale economies and location economies.

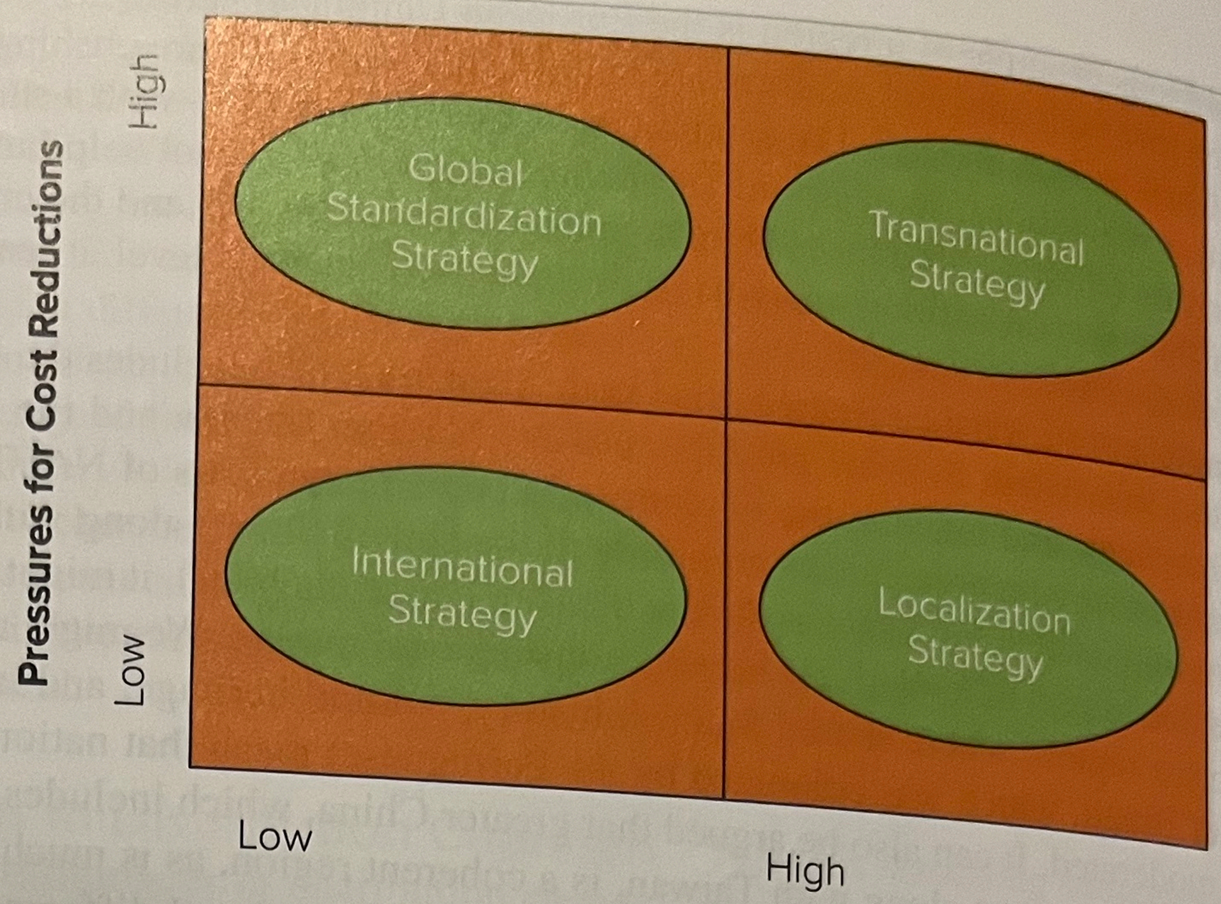
In addition, pressures for local responsiveness imply that it may not be possible to leverage skills and products associated with a firm's core competencies wholesale from one nation or region to another. Concessions often have to be made to local conditions. Despite being depicted as "poster child" for the proliferation of standardized global products, even McDonald's has found that it has to customize its product offerings (i.e., its menu) to account for national differences in tastes and preferences.

How do differences in the strength of pressures for cost reductions versus those for local responsiveness affect a firm's choice of strategy? Firms typically choose among four main strategic postures when competing internationally. These can be characterized as a global

12.9 FIGURE

Four basic strategies.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).



standardization strategy, a localization strategy, a transnational strategy, and an international strategy.[37] The appropriateness of each strategy varies, given the extent of pressures for cost reductions and local responsiveness. Figure 12.9 illustrates the conditions under which each of these strategies is most appropriate.

global standardization strategy
A firm focuses on increasing profitability and profit growth by reaping the cost reductions that come from economies of scale, learning effects, and location economies.

GLOBAL STANDARDIZATION STRATEGY

Firms that pursue a **global standardization strategy** focus on increasing profitability and profit growth by reaping the cost reductions that come from economies of scale, learning effects, and location economies; that is, their strategic goal is to pursue a low-cost strategy on a global scale. The production, marketing, and R&D activities of firms pursuing a global standardization strategy are concentrated in a few favorable locations. Firms pursuing a global standardization strategy try not to customize their product offering and marketing strategy to local conditions because customization involves shorter production runs and the duplication of functions, which tends to raise costs. Instead, they prefer to market a standardized product worldwide so that they can reap the maximum benefits from economies of scale and learning effects. They also tend to use their cost advantage to support aggressive pricing in world markets.

This strategy makes most sense when there are strong pressures for cost reductions and demands for local responsiveness are minimal. Increasingly, these conditions prevail in many industrial goods industries, whose products often serve universal needs. In the semiconductor industry, for example, global standards have emerged, creating enormous demands for standardized global products. Accordingly, companies such as Intel, Texas Instruments, and Motorola all pursue a global standardization strategy. However, these conditions are not always found in many consumer goods markets, where demands for local responsiveness can remain high. The strategy is inappropriate when demands for local responsiveness are high. To focus on global strategy with local responsiveness, take a look at the accompanying Management Focus on Unilever's global organization.

More Customized Products in the Global Marketplace?

The Coca-Cola Company's (TCCC) Minute Maid Pulpy became the cola giant's 14th brand to reach $1 billion in global retail sales. As opposed to cola carbonates, which often rely on global brand recognition and cross-generational formulas for success, Minute Maid Pulpy has relied on product development and innovations inspired by local flavors and textures. Minute Maid Pulpy contains less than 24 percent actual fruit juice, but Coca-Cola was able to retail the product at a much lower price point than products with a higher content of fruit juice. In China and throughout the Asia-Pacific region, consumer notions of freshness and health are connected much more to the consumption of actual fruit. Minute Maid Pulpy acknowledged this by including pieces of fruit in the drink, thereby creating a thicker texture that would not appeal to most North American consumers but has proven very popular in this region of the world. In customizing the product, Minute Maid Pulpy went from the 10th most popular fruit/vegetable juice brand in China to first. But isn't the world becoming more globalized? Do we still need large multinational corporations customizing their products to local markets?

Source: http://blog.euromonitor.com.

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Unilever's Global Organization

Unilever (unilever.com) is a Dutch–British company co-headquartered in Rotterdam, Netherlands, and London, United Kingdom. The company was founded in 1930 by the merger of the Dutch margarine producer Margarine Unie and the British soapmaker Lever Brothers. Unilever owns more than 400 brands, but the core of its assortment are 14 brands that have annual sales of more than €1 billion: Axe/Lynx, Dove, Omo, Becel/Flora, Heartbrand ice creams, Hellmann's, Knorr, Lipton, Lux, Magnum, Rama, Rexona, Sunsilk, and Surf.

With the Dutch–British background, Unilever is a dual-listed company consisting of Unilever NV based in Rotterdam and Unilever PLC based in London. The dual-listed company operates as a single business, with a shared board of directors. However, Unilever NV and Unilever PLC have different shareholder constituencies, and shareholders cannot convert or exchange the shares of one company for shares of the other.

The Unilever Group—integration of Unilever NV (Netherlands) and Unilever PLC (United Kingdom)—is organized and made functional by a number of agreements between the parent companies of NV and PLC. These agreements, together with provisions in their respective articles of association, are jointly known as the Foundation Agreements. These Foundation Agreements enable Unilever to attain unity of management, operations, shareholders' rights, purpose, and mission.

Unilever's Equalization Agreement regulates the common rights of the shareholders of both NV and PLC. The objective of the Equalization Agreement is to ensure that the positions of these two sets of shareholders are as similar as possible. The idea is to ensure that both groups of owners are treated as if they held shares in a single company.

Unilever's unity of operations is facilitated by a Deed of Mutual Covenants. This deed is an agreement between NV and PLC that provides for the allocation of assets within the Unilever Group. Relatedly, the Agreement for Mutual Guarantees of Borrowing also assists in the creation of the single operating platform where the objective, again, is to attain unity of management, operations, shareholders' rights, purpose, and mission. In effect, this mutual guarantees agreement ensures that Unilever is financially as robust as possible, using the combined strength of NV and PLC, when asking lenders for certain significant public borrowings.

To structure its operations and management of the more than 400 brands, Unilever is organized into four main divisions: Foods, Refreshment (beverages and ice cream), Home Care, and Personal Care. These divisions employ about 170,000 people, produce sales of some €55 billion annually (about 60 billion U.S. dollars), and have 57 percent of their business in emerging markets. On a daily basis, a staggering number of 2.5 billion people worldwide use Unilever products (out of the 7.5 billion people in the world).

Sources: "About Unilever," March 22, 2017, www.unilever.com/about/who-we-are/about-Unilever; "Unilever's Legal Structure and Foundation Agreements," March 22, 2017, www.unilever.com/investor-relations/agm-and-corporate-governance/legal-structure-and-foundation-agreements; Port Sunlight, "Unilever: In Search of the Good Business," *The Economist*, August 9, 2014; and Rob Davies, "Unilever Bids to Heal Shareholder Rift Amid 'Garage Sale' Warnings," *The Guardian*, March 19, 2017.

LOCALIZATION STRATEGY

A **localization strategy** focuses on increasing profitability by customizing the firm's goods or services so that they provide a good match to tastes and preferences in different national or regional markets. Localization is most appropriate when there are substantial differences across nations or regions with regard to consumer tastes and preferences and where cost pressures are not too intense. By customizing the product offering to local demands, the firm increases the value of that product in the local market. On the downside, because it involves some duplication of functions and smaller production runs, customization limits the ability of the firm to capture the cost reductions associated with mass-producing a standardized product for global consumption. The strategy may make sense, however, if the added value associated with local customization supports higher pricing, which enables the firm to recoup its higher costs, or if it leads to substantially greater local demand, enabling the firm to reduce costs through the attainment of some scale economies in the local market.

localization strategy
Increasing profitability by customizing the firm's goods and services so that they provide a good match to tastes and preferences in different national markets.

At the same time, firms still have to keep an eye on costs. Firms pursuing a localization strategy still need to be efficient and, whenever possible, to capture some scale economies from their global reach. As noted earlier, many automobile companies have found that they have to customize some of their product offerings to local market demands—for example, producing large pickup trucks for North American consumers and small fuel-efficient cars for Europeans and Japanese. At the same time, these multinationals try to get some scale economies from their global volume by using common vehicle platforms and components across many different models and manufacturing those platforms and components at efficiently scaled factories that are optimally located. By designing their products in this way, these companies have been able to localize their product offerings, yet simultaneously capture some scale economies, learning effects, and location economies.

TRANSNATIONAL STRATEGY

We have argued that a global standardization strategy makes most sense when cost pressures are intense and demands for local responsiveness are limited. Conversely, a localization strategy makes most sense when demands for local responsiveness are high, but cost pressures are moderate or low. What happens, however, when the firm simultaneously faces both strong cost pressures and strong pressures for local responsiveness? How can managers balance the competing and inconsistent demands such divergent pressures place on the firm? According to some researchers, the answer is to pursue what has been called a transnational strategy.

Two of these researchers, Christopher Bartlett and Sumantra Ghoshal, argue that in the modern global environment, competitive conditions are so intense that to survive, firms must do all they can to respond to pressures for cost reductions and local responsiveness.[38] They must try to realize location economies and experience effects, leverage products internationally, transfer core competencies and skills within the company, and simultaneously pay attention to pressures for local responsiveness.[39] Bartlett and Ghoshal note that in the modern multinational enterprise, core competencies and skills do not reside just in the home country but can develop in any of the firm's worldwide operations. Thus, they maintain that the flow of skills and product offerings should not be all one way, from home country to foreign subsidiary. Rather, the flow should also be from foreign subsidiary to home country and from foreign subsidiary to foreign subsidiary. Transnational enterprises, in other words, must also focus on leveraging subsidiary skills.

transnational strategy
Attempt to simultaneously achieve low costs through location economies, economies of scale, and learning effects while also differentiating product offerings across geographic markets to account for local differences and fostering multidirectional flows of skills between different subsidiaries in the firm's global network of operations.

In essence, firms that pursue a **transnational strategy** are trying to simultaneously achieve low costs through location economies, economies of scale, and learning effects; differentiate their product offering 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. As attractive as this may sound in theory, the strategy is not an easy one to pursue because it places conflicting demands on the company. Differentiating the product to respond to local demands in different geographic markets raises costs, which runs counter to the goal of reducing costs. Companies such as 3M and ABB (one of the world's largest engineering conglomerates) have tried to embrace a transnational strategy and found it difficult to implement.

How best to implement a transnational strategy is one of the most complex questions that large multinationals are grappling with today. Few, if any, enterprises have perfected this strategic posture. But some clues as to the right approach can be derived from a number of companies. For an example, consider the case of Caterpillar. The need to compete with low-cost competitors such as Komatsu of Japan forced Caterpillar to look for greater cost economies. However, variations in construction practices and government regulations across countries and regions mean that Caterpillar also has to be responsive to local demands. Therefore, Caterpillar confronted significant pressures for cost reductions *and* for local responsiveness.

To deal with cost pressures, Caterpillar redesigned its products to use many identical components and invested in a few large-scale component manufacturing facilities, sited at favorable locations, to fill global demand and realize scale economies. At the same time, the company augments the centralized manufacturing of components with assembly plants in each of its major global markets. At these plants, Caterpillar adds local product features, tailoring the finished product to local needs. Thus, Caterpillar is able to realize many of the benefits of global manufacturing while reacting to pressures for local responsiveness by differentiating its product among national markets.[40] Caterpillar started to pursue this strategy, and a few years later it had succeeded in doubling output per employee, significantly reducing its overall cost structure in the process. Meanwhile, Komatsu and Hitachi, which are still wedded to a Japan-centric global strategy, have seen their cost advantages evaporate and have been steadily losing market share to Caterpillar.

Changing a firm's strategic posture to build an organization capable of supporting a transnational strategy is a complex and challenging task. Some would say it is too complex because the strategy implementation problems of creating a viable organizational structure and control systems to manage this strategy are immense.

INTERNATIONAL STRATEGY

Sometimes it is possible to identify multinational firms that find themselves in the fortunate position of being confronted with low cost pressures and low pressures for local responsiveness. Many of these enterprises have pursued an **international strategy**, taking products first produced for their domestic market and selling them internationally with only minimal local customization. The distinguishing feature of many such firms is that they are selling a product that serves universal needs, but they do not face significant competitors; thus, unlike firms pursuing a global standardization strategy, they are not confronted with pressures to reduce their cost structure. Xerox found itself in this position in the 1960s, after its invention and commercialization of the photocopier. The technology underlying the photocopier was protected by strong patents, so for several years, Xerox did not face competitors—it had a monopoly. The product serves universal needs, and it was highly valued in most developed nations. Thus, Xerox was able to sell the same basic product the world over, charging a relatively high price for that product. Because Xerox did not face direct competitors, it did not have to deal with strong pressures to minimize its cost structure.

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

Firms that have pursued this strategy include Procter & Gamble and Microsoft. Historically, Procter & Gamble developed innovative new products in Cincinnati and then transferred them wholesale to local markets (see the accompanying Management Focus). Similarly, the bulk of Microsoft's product development work occurs in Redmond, Washington, where the company is headquartered. Although some localization work is undertaken elsewhere, this is limited to producing foreign-language versions of popular Microsoft programs.

Is Citigroup Now the Best in Financials?

Recent earnings reports of the financials showed a separation between the more internationally focused business models of Bank of America and Citigroup from the more domestically focused growth strategies of JP Morgan and Wells Fargo. The banking sector in the United States is heavily saturated, and the financials that rely primarily on the domestic economy for growth continue to struggle. Today, when you look at Citigroup's business model, the company looks like an international bank headquartered in the United States because the company gets nearly 70 percent of its revenue overseas. The company is strongly positioned in almost every major emerging market economy, with bold plans for continued future growth. In Latin America, for instance, Eduardo Cruz, one of the most respected executives in the banking industry, continues to successfully build out Citigroup's retail and investment banking presence. Also, in Asia, where Citigroup has its largest international footprint, the company continues to be similarly successful in building out its core banking business across the region, with a particularly strong retail franchise in India. Based on the material in Chapter 12, do you think Citigroup is using a global standardization strategy, localization strategy, transnational strategy, or international strategy? And, perhaps more interestingly, is Citigroup now the best in financials?

Source: http://seekingalpha.com.

international strategy
Trying to create value by transferring core competencies to foreign markets where indigenous competitors lack those competencies.

THE EVOLUTION OF STRATEGY

The Achilles' heel of the international strategy is that over time, competitors inevitably emerge, and if managers do not take proactive steps to reduce their firm's cost structure, it will be rapidly outflanked by efficient global competitors. This is what happened to Xerox. Japanese companies such as Canon ultimately invented their way around Xerox's patents, produced their own photocopiers in very efficient manufacturing plants, priced them below Xerox's products, and rapidly took global market share from Xerox. In the final analysis, Xerox's demise was not due to the emergence of competitors—because, ultimately, that was bound to occur—but due to its failure to proactively reduce its cost structure in advance of the emergence of efficient global competitors. The message in this story is that an international strategy may not be viable in the long term and to survive, firms need to shift toward a global standardization strategy or a transnational strategy in advance of competitors (see Figure 12.10).

management FOCUS

Evolution of Strategy at Procter & Gamble

Founded in 1837, Cincinnati-based Procter & Gamble (P&G) has long been one of the world's most international companies. Today, P&G is a global colossus in the consumer products business with annual sales in excess of $80 billion, some 54 percent of which are generated outside of the United States. P&G sells more than 300 brands—including Ivory soap, Tide, Pampers, IAMS pet food, Crisco, and Folgers—to consumers in 180 countries. Historically, the strategy at P&G was well established. The company developed new products in Cincinnati and then relied on semiautonomous foreign subsidiaries to manufacture, market, and distribute those products in different nations. In many cases, foreign subsidiaries had their own production facilities and tailored the packaging, brand name, and marketing message to local tastes and preferences. For years, this strategy delivered a steady stream of new products and reliable growth in sales and profits. By the 1990s, however, profit growth at P&G was slowing.

The essence of the problem was simple; P&G's costs were too high because of extensive duplication of manufacturing, marketing, and administrative facilities in different national subsidiaries. The duplication of assets made sense in the world of the 1960s, when national markets were segmented from each other by barriers to cross-border trade. Products produced in Great Britain, for example, could not be sold economically in Germany due to high tariff duties levied on imports into Germany. By the 1980s, however, barriers to cross-border trade were falling rapidly worldwide and fragmented national markets were merging into larger regional or global markets. Also, the retailers through which P&G distributed its products were growing larger and more global, such as Walmart, Tesco from the United Kingdom, and Carrefour from France. These emerging global retailers were demanding price discounts from P&G.

In the 1990s, P&G embarked on a major reorganization in an attempt to control its cost structure and recognize the new reality of emerging global markets. The company shut down some 30 manufacturing plants around the globe, laid off 13,000 employees, and concentrated production in fewer plants that could better realize economies of scale and serve regional markets. It wasn't enough! Profit growth remained sluggish, so in 1999, P&G launched its second reorganization of the decade. Named "Organization 2005," the goal was to transform P&G into a truly global company.

The company tore up its old organization, which was based on countries and regions, and replaced it with one based on seven self-contained global business units, ranging from baby care to food products. Each business unit was given complete responsibility for generating profits from its products and for manufacturing, marketing, and product development. Each business unit was told to rationalize production, concentrating it in fewer larger facilities; to build global brands wherever possible, thereby eliminating marketing differences among countries; and to accelerate the development and launch of new products.

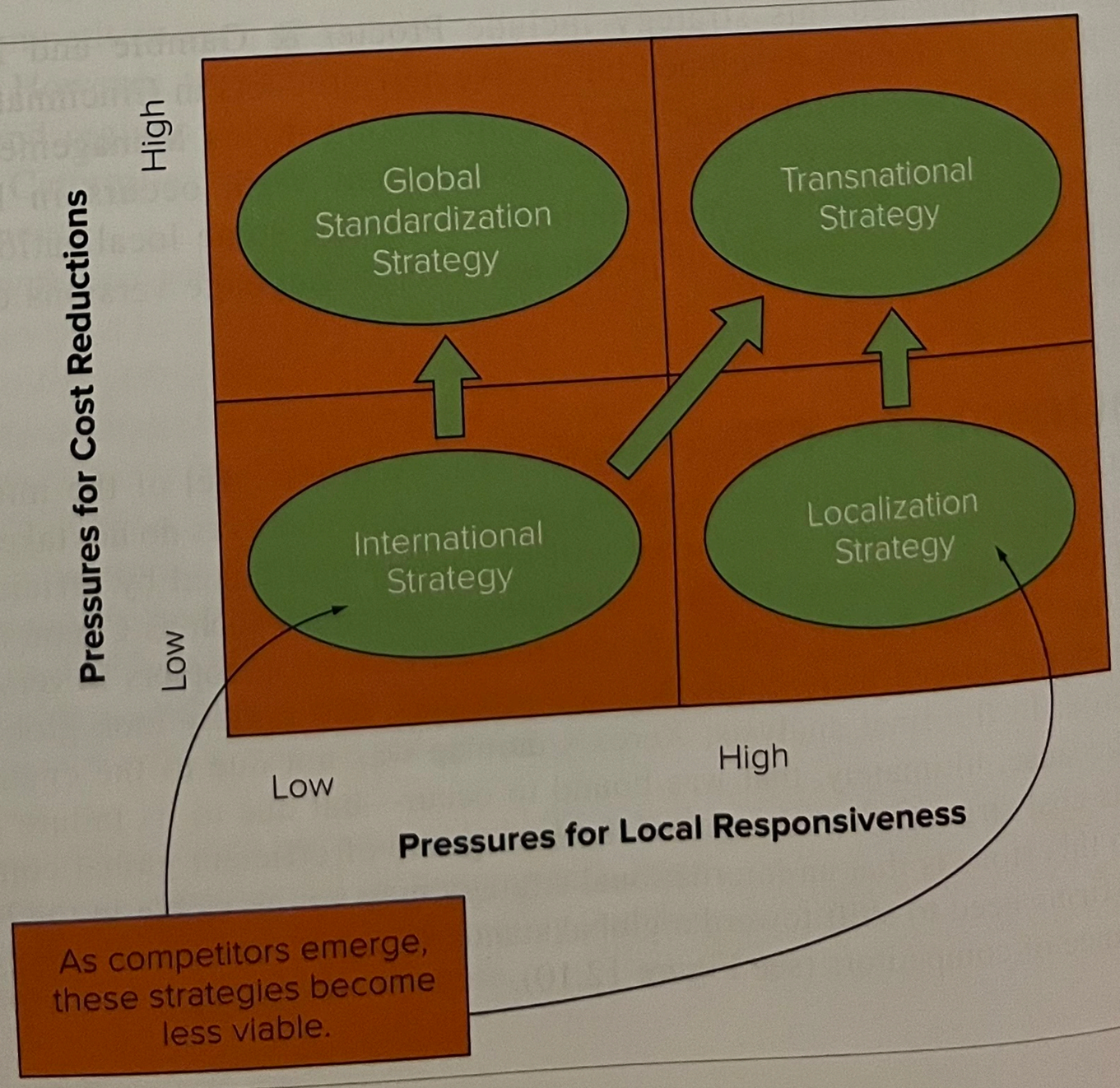
P&G announced that as a result of this initiative, it would close another 10 factories and lay off 15,000 employees, mostly in Europe where there was still extensive duplication of assets. The annual cost savings were estimated to be about $800 million. P&G planned to use the savings to cut prices and increase marketing spending in an effort to gain market share and thus further lower costs through the attainment of scale economies. This time, the strategy seemed to be working. P&G has now reported strong growth in both sales and profits. Significantly, P&G's global competitors, such as Unilever, Kimberly-Clark, and Colgate-Palmolive, were struggling during the same time period.

Sources: J. Neff, "P&G Outpacing Unilever in Five-Year Battle," *Advertising Age*, November 3, 2003, pp. 1–3; G. Strauss, "Firm Restructuring into Truly Global Company," *USA Today*, September 10, 1999, p. B2; *Procter & Gamble 10K Report*, 2005; and M. Kolbasuk McGee, "P&G Jump-Starts Corporate Change," *Information Week*, November 1, 1999, pp. 30–34.

12.10 FIGURE

Changes in strategy over time.

Source: C. W. L. Hill and G. T. M. Hult, International Business: Competing in the Global Marketplace (New York: McGraw-Hill Education, 2017).



The same can be said about a localization strategy. Localization may give a firm a competitive edge, but if it is simultaneously facing aggressive competitors, the company will also have to reduce its cost structure, and the only way to do that may be to shift toward a transnational strategy. This is what Procter & Gamble has been doing (see the earlier Management Focus). Thus, as competition intensifies, international and localization strategies tend to become less viable, and managers need to orient their companies toward either a global standardization strategy or a transnational strategy.

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Strategic Alliances

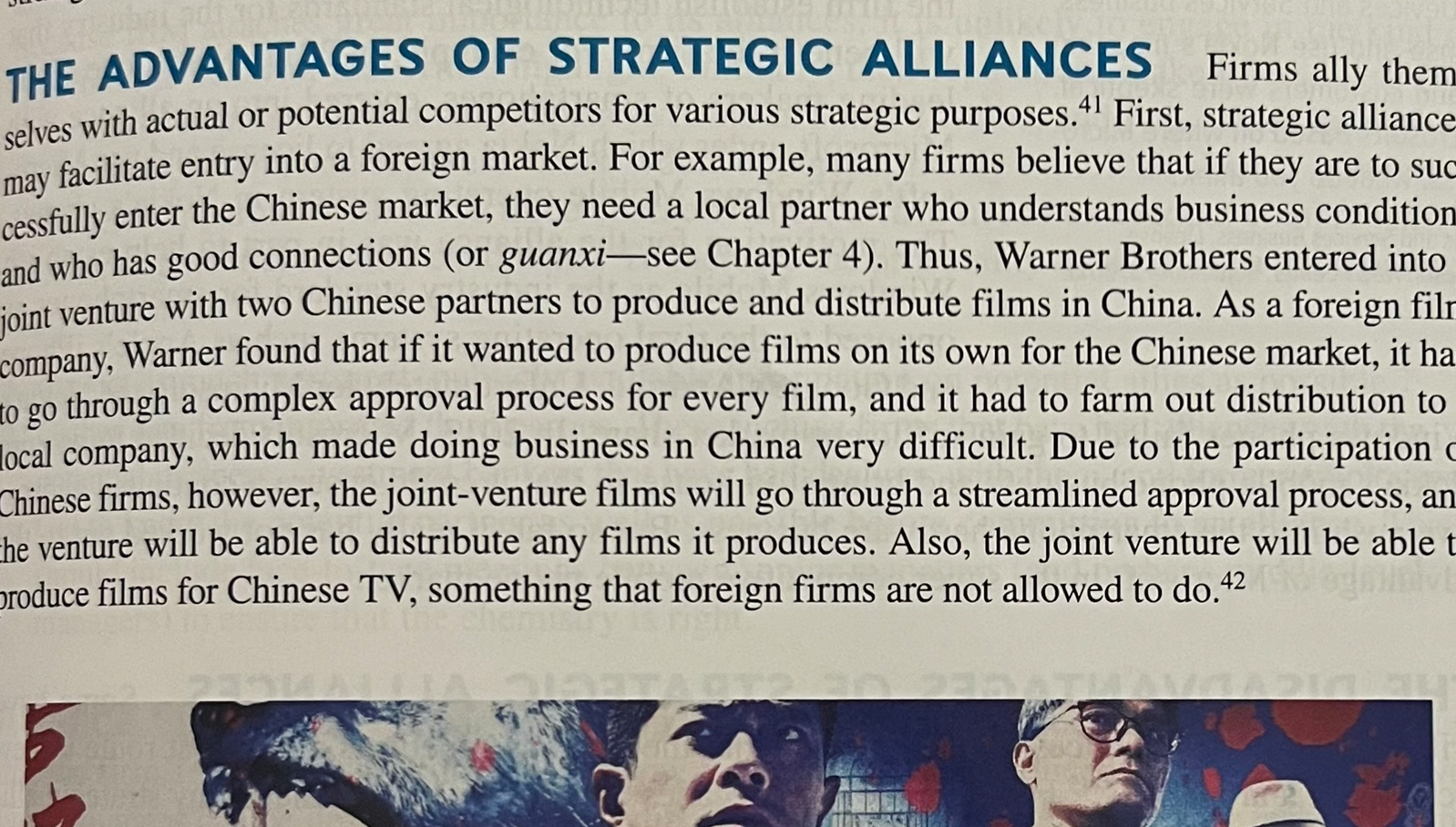
LO 12-5

Explain the pros and cons of using strategic alliances to support international strategies.

Strategic alliances refer to cooperative agreements between potential or actual competitors. In this section, we are concerned specifically with strategic alliances between firms from different countries. Strategic alliances run the range from formal joint ventures, in which two or more firms have equity stakes (e.g., Fuji Xerox), to short-term contractual agreements, in which two companies agree to cooperate on a particular task (such as developing a new product). Collaboration between competitors is fashionable; recent decades have seen an explosion in the number of strategic alliances.

THE ADVANTAGES OF STRATEGIC ALLIANCES

Firms ally themselves with actual or potential competitors for various strategic purposes.[41] First, strategic alliances may facilitate entry into a foreign market. For example, many firms believe that if they are to successfully enter the Chinese market, they need a local partner who understands business conditions and who has good connections (or *guanxi*—see Chapter 4). Thus, Warner Brothers entered into a joint venture with two Chinese partners to produce and distribute films in China. As a foreign film company, Warner found that if it wanted to produce films on its own for the Chinese market, it had to go through a complex approval process for every film, and it had to farm out distribution to a local company, which made doing business in China very difficult. Due to the participation of Chinese firms, however, the joint-venture films will go through a streamlined approval process, and the venture will be able to distribute any films it produces. Also, the joint venture will be able to produce films for Chinese TV, something that foreign firms are not allowed to do.[42]



(L-R) Canadian actor Chris Collins, actress Jacky Cai and actress Hanna Chan arrive at the red carpet of the premiere of film 'Paradox' on August 14, 2017 in Beijing, China. The strategic alliance between Warner Brothers and their Chinese partners has helped streamline the process for film distribution.

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Was Nokia a Risky Purchase for Microsoft?

Microsoft Corporation's acquisition of Nokia Corporation's devices and services business was seen as a bold but risky gamble in the software giant's bid for a larger footprint in the fast-growing mobile market. Initially, it relied heavily on a strategic alliance with Nokia, which in 2011 announced that it was embracing Microsoft's Windows Phone as its main operating system. This partnership produced Lumia, a Windows-based Nokia phone. Nokia got caught in a tough transition from its phones based on its Symbian operating system to Windows-based devices, and this transition has been more painful than Nokia anticipated. Despite the somewhat rocky start to their alliance, in September 2013, Microsoft and Nokia announced that the two companies "have decided to enter into a transaction whereby Microsoft will purchase substantially all of Nokia's Devices and Services business, license Nokia's patents, and license and use Nokia's mapping services." Experts, the markets, and customers were skeptical. Was Nokia a risky purchase for Microsoft? Based on where Microsoft is today with its phone business, what do you think?

Source: "Microsoft to Acquire Nokia's Devices and Services Business, License Nokia's Patents and Mapping Services," *Microsoft News Center*, September 3, 2013.

Strategic alliances also allow firms to share the fixed costs (and associated risks) of developing new products or processes. An alliance between Boeing and a number of Japanese companies to build Boeing's latest commercial jetliner, the 787, was motivated by Boeing's desire to share the estimated $8 billion investment required to develop the aircraft.

Third, an alliance is a way to bring together complementary skills and assets that neither company could easily develop on its own.[43] In 2003, for example, Microsoft and Toshiba established an alliance aimed at developing embedded microprocessors (essentially tiny computers) that can perform a variety of entertainment functions in an automobile (e.g., run a backseat DVD player or a wireless Internet connection). The processors run a version of Microsoft's Windows operating system. Microsoft brings its software engineering skills to the alliance and Toshiba its skills in developing microprocessors.[44]

Fourth, it can make sense to form an alliance that will help the firm establish technological standards for the industry that will benefit the firm. For example, in 2011, Nokia, one of the leading makers of smartphones, entered into an alliance with Microsoft under which Nokia agreed to license and use Microsoft's Windows Mobile operating system in Nokia's phones. The motivation for the alliance was in part to help establish Windows Mobile as the industry standard for smartphones as opposed to the rival operating systems such as Apple's iPhone and Google's Android. Unfortunately for Microsoft, the Nokia's Windows phones failed to gain sufficient market share. In 2013, Microsoft decided to acquire Nokia's mobile phone business and bring it in house so that it could ensure a continued aggressive push into the smartphone hardware business. But so far, it really has not worked out to the advantage of Microsoft in the super-competitive mobile phone market.

THE DISADVANTAGES OF STRATEGIC ALLIANCES

Some have criticized strategic alliances on the grounds that they give competitors a low-cost route to new technology and markets.[45] For example, two decades ago, critics argued that many strategic alliances between U.S. and Japanese firms were part of an implicit Japanese strategy to keep high-paying, high-value-added jobs in Japan while gaining the project engineering and production process skills that underlie the competitive success of many U.S. companies.[46] They argued that Japanese success in the machine tool and semiconductor industries was built on U.S. technology acquired through strategic alliances. And they argued that U.S. managers were aiding the Japanese by entering alliances that channel new inventions to Japan and provide a U.S. sales and distribution network for the resulting products. Although such deals may generate short-term profits, so the argument goes, in the long run, the result is to "hollow out" U.S. firms, leaving them with no competitive advantage in the global marketplace. The same arguments are now made regarding alliances with Chinese firms.

These critics have a point; alliances have risks. Unless a firm is careful, it can give away more than it receives. But there are so many examples of apparently successful alliances between firms—including alliances between U.S. and Japanese firms—that the critics' position seems extreme. It is difficult to see how the Microsoft–Toshiba alliance, the Boeing–Mitsubishi alliance for the 787, and the Fuji–Xerox alliance fit the critics' thesis. In these cases, both partners seem to have gained from the alliance. Why do some alliances benefit both firms while others benefit one firm and hurt the other? The next section provides an answer to this question.

MAKING ALLIANCES WORK

The failure rate for international strategic alliances seems to be high. One study of international strategic alliances found that two-thirds of them run into serious managerial and financial troubles within two years of their formation and

that although many of these problems are solved, 33 percent are ultimately rated as failures by the parties involved.[47] The success of an alliance seems to be a function of three main factors: partner selection, alliance structure, and the manner in which the alliance is managed.

Partner Selection

A good ally, or partner, has three characteristics. First, a good partner helps the firm achieve its strategic goals, whether they are market access, sharing the costs and risks of product development, or gaining access to critical core competencies. The partner must have capabilities that the firm lacks and that it values. Second, a good partner shares the firm's vision for the purpose of the alliance. If two firms approach an alliance with radically different agendas, the chances are great that the relationship will not be harmonious, will not flourish, and will end in divorce. Third, a good partner is unlikely to try to opportunistically exploit the alliance for its own ends, that is, to expropriate the firm's technological know-how while giving away little in return. In this respect, firms with reputations for "fair play" probably make the best allies. For example, companies such as General Electric are involved in so many strategic alliances that it would not pay the company to trample over individual alliance partners.[48] This would tarnish GE's reputation of being a good ally and would make it more difficult for GE to attract alliance partners. Because IBM attaches great importance to its alliances, it is unlikely to engage in the kind of opportunistic behavior that critics highlight. Similarly, their reputations make it less likely (but by no means impossible) that such Japanese firms as Sony, Toshiba, and Fuji, which have histories of alliances with non-Japanese firms, would opportunistically exploit an alliance partner.

To select a partner with these three characteristics, a firm needs to conduct comprehensive research on potential alliance candidates. To increase the probability of selecting a good partner, the firm should

1. Collect as much pertinent, publicly available information on potential allies as possible.
2. Gather data from informed third parties. These include firms that have had alliances with the potential partners, investment bankers that have had dealings with them, and former employees.
3. Get to know the potential partner as well as possible before committing to an alliance. This should include face-to-face meetings between senior managers (and perhaps middle-level managers) to ensure that the chemistry is right.

Alliance Structure

A partner having been selected, the alliance should be structured so that the firm's risks of giving too much away to the partner are reduced to an acceptable level. First, alliances can be designed to make it difficult (if not impossible) to transfer technology not meant to be transferred. The design, development, manufacture, and service of a product manufactured by an alliance can be structured so as to wall off sensitive technologies to prevent their leakage to the other participant. In a long-standing alliance between General Electric and Snecma to build commercial aircraft engines for single-aisle commercial jet aircraft, for example, GE reduced the risk of excess transfer by walling off certain sections of the production process. The modularization effectively cut off the transfer of what GE regarded as key competitive technology, while permitting Snecma access to final assembly. Formed in 1974, the alliance has been a remarkably long-term success, and it now dominates the market for certain jet engines used by Boeing and Airbus.[49] Similarly, in the alliance between Boeing and the Japanese to build the 767, Boeing walled off research, design, and marketing functions considered central to its competitive position, while allowing the Japanese to share in production technology. Boeing also walled off new technologies not required for 767 production.[50]

Second, contractual safeguards can be written into an alliance agreement to guard against the risk of opportunism by a partner. (Opportunism includes the theft of technology and/or markets.) For example, TRW Inc. entered into three strategic alliances with large Japanese auto component suppliers to produce seat belts, engine valves, and steering gears for sale to Japanese-owned auto assembly plants in the United States. TRW put clauses in each of its alliance contracts that barred the Japanese firms from competing with TRW to supply U.S.-owned auto companies with component parts. By doing this, TRW protected itself against the possibility that the Japanese companies were entering into the alliances merely to gain access to the North American market to compete with TRW in its home market.

Third, both parties to an alliance can agree in advance to swap skills and technologies that the other covets, thereby ensuring a chance for equitable gain. Cross-licensing agreements are one way to achieve this goal. Fourth, the risk of opportunism by an alliance partner can be reduced if the firm extracts a significant credible commitment from its partner in advance. The long-term alliance between Xerox and Fuji to build photocopiers for the Asian market perhaps best illustrates this. Rather than enter into an informal agreement or a licensing arrangement (which Fuji Photo initially wanted), Xerox insisted that Fuji invest in a 50/50 joint venture to serve Japan and East Asia. This venture constituted such a significant investment in people, equipment, and facilities that Fuji Photo was committed from the outset to making the alliance work in order to earn a return on its investment. By agreeing to the joint venture, Fuji essentially made a credible commitment to the alliance. Given this, Xerox felt secure in transferring its photocopier technology to Fuji.[51]

Managing the Alliance

Once a partner has been selected and an appropriate alliance structure has been agreed on, the task facing the firm is to maximize its benefits from the alliance. As in all international business deals, an important factor is sensitivity to cultural differences (see Chapter 4). Many differences in management style are attributable to cultural differences, and managers need to make allowances for these in dealing with their partner. Beyond this, maximizing the benefits from an alliance seems to involve building trust between partners and learning from partners.[52]

Managing an alliance successfully requires building interpersonal relationships between the firms' managers, or what is sometimes referred to as *relational capital*.[53] This is one lesson that can be drawn from a successful strategic alliance between Ford and Mazda. Ford and Mazda set up a framework of meetings within which their managers not only discuss matters pertaining to the alliance but also have time to get to know each other better. The belief is that the resulting friendships help build trust and facilitate harmonious relations between the two firms. Personal relationships also foster an informal management network between the firms. This network can then be used to help solve problems arising in more formal contexts (such as in joint committee meetings between personnel from the two firms).

Academics have argued that a major determinant of how much acquiring knowledge a company gains from an alliance is its ability to learn from its alliance partner.[54] For example, in a five-year study of strategic alliances between major multinationals, Gary Hamel, Yves Doz, and C. K. Prahalad focused on a number of alliances between Japanese companies and Western (European or American) partners.[55] In every case in which a Japanese company emerged from an alliance stronger than its Western partner, the Japanese company had made a greater effort to learn. Few Western companies studied seemed to want to learn from their Japanese partners. They tended to regard the alliance purely as a cost-sharing or risk-sharing device, rather than as an opportunity to learn how a potential competitor does business.

Consider the alliance between General Motors and Toyota constituted in 1985 to build the Chevrolet Nova. This alliance was structured as a formal joint venture, called New United Motor Manufacturing Inc., and each party had a 50 percent equity stake. The venture owned an auto plant in Fremont, California. According to one Japanese manager, Toyota quickly achieved most of its objectives from the alliance: "We learned about U.S. supply and transportation. And we got the confidence to manage U.S. workers."[56] All that knowledge was then transferred to Georgetown, Kentucky, where Toyota opened its own plant in 1988. Possibly all GM got was a new product, the Chevrolet Nova. Some GM managers complained that the knowledge they gained through the alliance with Toyota has never been put to good use inside GM. They believe they should have been kept together as a team to educate GM's engineers and workers about the Japanese system. Instead, they were dispersed to various GM subsidiaries.

To maximize the learning benefits of an alliance, a firm must try to learn from its partner and then apply the knowledge within its own organization. It has been suggested that all operating employees should be well briefed on the partner's strengths and weaknesses and should understand how acquiring particular skills will bolster their firm's competitive position. Hamel and Prahalad note that this is already standard practice among Japanese companies. They made this observation: