

Strategy & the firm

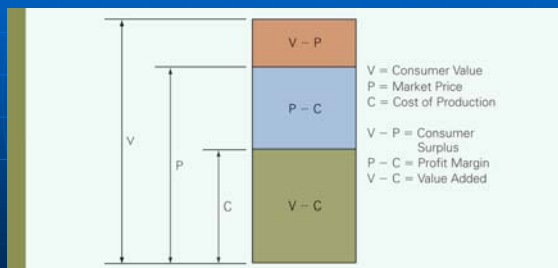
- Strategy: actions that managers must take to attain the goals of the firm
- Main goal usually to maximize long-term profit (Π)
- Profitability defined by return on sales or return on equity

Value creation

- Profit determined by :
 - The amount of value customers place on firm's goods or services (V)
 - Firm's cost of production (C)
- Consumer surplus occurs when price charged by a firm on a good or service is less than value placed on it by a customer
- Value creation = $V - C$
- Two basic strategies to create value and attain competitive advantage according to Porter:
 - Low cost
 - Differentiation strategy

Value creation

Fig 12.1

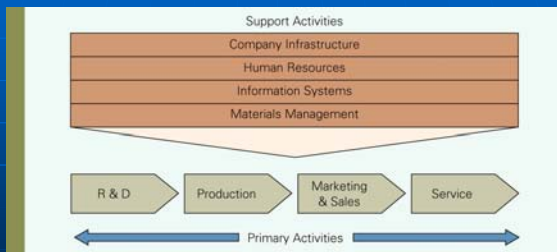


Firm as a value chain

- Any firm is composed of a series of distinct value creating activities
- Primary activities
 - Research & development
 - Production
 - Marketing & sales
 - Service
- Support Activities
 - Materials management or logistics
 - Human resource
 - Information systems
 - Company infrastructure

Firm as a value chain

Fig 12.3



Strategy in international business

- Strategy is concerned with identifying and taking actions that will lower costs of value creation and/or differentiate the firm's product offering through superior design, quality service, functionality, etc.

DEFINITIONS

Global Business: Minimum volume required for cost efficiency is not available in home market.

Global Competition: Firms subsidize national market share battles in pursuit of global brand name and distribution.

Global Company: Firms have distribution in key foreign markets that enable cross subsidization, international retaliation & world wide volume.

Factors Promoting the Globalization of Industries

- Narrowing of demand characteristics
- Escalating costs of R & D
- Cost reduction pressures & economies of scale
- Government industrial policies
- Reduction of factor costs(e.g. labor, capital)
- Rise of new distribution channels
- Reduction of transportation, communication, and storage costs

Sources of Global Comparative Advantage

- transferring core competencies
- production economies of scale
- global experience
- logistical economies of scale
- marketing economies of scale
- product differentiation
- local responsiveness
- proprietary product technology

Advantages of global expansion

- Location economies
- Cost economies from experience effects
- Leveraging core competencies
- Leveraging subsidiary skills

- Profitability is constrained by product customization and the "imperative of localization".

Economic Impediments to Global Competition

- transportation and storage costs
- differing product needs
- established distribution channels in national markets
- sales force
- lack of world demand
- complex segmentation within geographic markets

Impediments to Global Competition

Managerial

- differing marketing needs
- intensive local services

Institutional

- government restrictions
- resource constraints
- perceptual

Location economies

- Realized by performing a value creation activity in an optimal location anywhere around the globe
- Often arise due to differences in factor costs
- It can lower costs of value to enable low cost strategy and/or
- Help in differentiation of products from competitors
- Global web: different stages of value chain are dispersed to those locations where perceived value is maximized or costs of value creation are minimized

Caveats

- Complications arise due to
 - Transportation costs
 - Trade barriers
 - Political and economic risks
- US firms have shifted production from Asia to Mexico due to
 - Low labor costs.
 - Proximity to U.S.
 - NAFTA.



Experience effects

- The systematic reduction in production costs that occurs over the life of a product
 - First observed in aircraft industry where unit costs reduced by 80% each time output was doubled
- Caused due to
 - Learning effects
 - Economies of scale

Learning effects

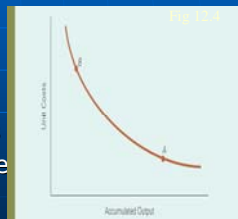
- Cost savings that come from learning by doing
- Arises due to increased worker productivity and management efficiency
- Significant in cases of technologically complex task as there is a lot to be learned
- Experienced during start-up phase, cease after two or three years
 - Decline after this point comes from economies of scale.

Economies of scale

- Refers to reduction in unit cost by producing a large volume of a product
- Sources:
 - Reduces fixed costs by spreading it over a large volume
 - Ability of large firms to employ increasingly specialized equipment or personnel

Strategic significance of the experience curve

- The firm that moves down the experience curve most rapidly has a cost advantage over its competitors
- Serving the global market from a single location helps to establish low cost strategy
- Aim to rapidly build up sales aggressive marketing strategies and first-mover advantages



Leveraging core competencies

- Core competence: Skills within the firm that competitors cannot easily match or imitate
- Earn greater returns by transferring these skills and/or unique product offerings to foreign markets who lack them
- Examples:
 - Consumer marketing skills of U.S. firms allowed them to dominate European consumer product market in 1960s and 70s

Leveraging subsidiary skills

- Value created by identifying them and applying it to a firm's global network of operations
- Some Challenges:
 - Managers must create an environment where incentives are given to take necessary risks and reward them
 - Need a process to identify new skill development
 - Need to facilitate transfer of new skills within the firm

Unique skills and ideas often developed in foreign subsidiaries



Pressures for cost reductions

- Intense in industries of standardized, commodity type product that serve universal needs
- Meaningful differentiation on non-price factors is difficult
- Major competitors are based in low-cost locations
- Consumers are powerful and face low switching costs
- Liberalization of world trade and investment environment
- Examples
 - Bulk chemicals, petroleum, steel, personal computers

Pressures for local responsiveness

- Differences in consumer tastes & preferences
 - North American families like pickup trucks while in Europe it is viewed as a utility vehicle for firms
- Differences in infrastructure & traditional practices
 - Consumer electrical system in North America is based on 110 volts; in Europe on 240 volts
- Differences in distribution channels
 - Germany has few retailers dominating the food market, while in Italy it is fragmented
- Host-Government demands
 - Health care system differences between countries require pharmaceutical firms to change operating procedures

Strategic choices

- Four basic strategies to enter and compete in the international environment:
 - International strategy
 - Multi domestic strategy
 - Global strategy
 - Transnational strategy

Four Basic Strategies

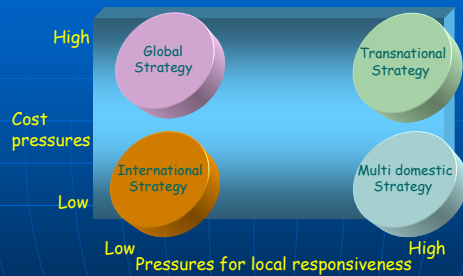


Figure 12.5

International strategy

- Create value by transferring valuable core competencies to foreign markets that indigenous competitors lack
- Centralize product development functions at home
- Establish manufacturing and marketing functions in local country but head office exercises tight control over it
- Limit customization of product offering and market strategy
 - Strategy effective if firm faces weak pressures for local responsive and cost reductions

International Strategy

- Transfer skills and products derived from core competencies to foreign markets, while undertaking some limited local customization.
- Suffer from lack of local responsiveness and an inability to exploit experience curve and location economies

Key Characteristics of a Global Strategy

- Standardized products
- Global economies of scale in key components and activities
- Leverage technology across many markets
- Global coordination of marketing and sales system-wide
- Cross-subsidization policies to respond to competitive moves by other global strategy firms

Benefits of Global Expansion

- Market growth and expansion opportunities
- Recovery of R&D and investment costs
- Creation of a distinct image
- Accelerated learning and transfer of new skills

Costs Associated with Global Expansion

- Costs of strategic leverage
 - sustained investment required
 - preserving and extending image
- Costs of flexibility
 - high interdependence of subsidiaries
 - change of development affecting all markets
- Costs of cooperation
 - compromise
 - accountability

Key Characteristics of a Multidomestic Strategy

- Customization or frequent adaptation of products for each separate market
- Few system-wide opportunities for economies of scale
- Value-adding activities performed and duplicated in each market
- Quality of marketing and sales across markets are important sources of competitive advantage

Transnational Strategy

- Firms exploit experience curve cost economies and location economies, transfer core competencies within the firm, and pay attention to pressures for local responsiveness.
- Global learning - knowledge flows from HQ to subs, subs to HQ, and subs to subs.

The Advantages and Disadvantages of the Four Strategies

| Strategy | Advantages | Disadvantages |
|----------------------|------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
| Global | Exploit experience curve effects | Lack of local responsiveness |
| International | Exploit location economies Transfer distinctive competencies to Foreign Markets | Lack of local responsiveness Inability to realize location economies Failure to exploit experience curve effects |

Table 12.1a

The Advantages and Disadvantages of the Four Strategies

| Strategy | Advantages | Disadvantages |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|
| Multi-domestic | Customize product offerings and marketing in accordance with local responsiveness | Inability to realize location economies Failure to exploit experience curve effects Failure to transfer distinctive competencies to foreign markets |
| Transnational | Exploit experience curve effects Exploit location economies Customize product offerings and marketing in accordance with local responsiveness Reap benefits of global learning | Difficult to implement due to organizational problems |

Table 12.1
