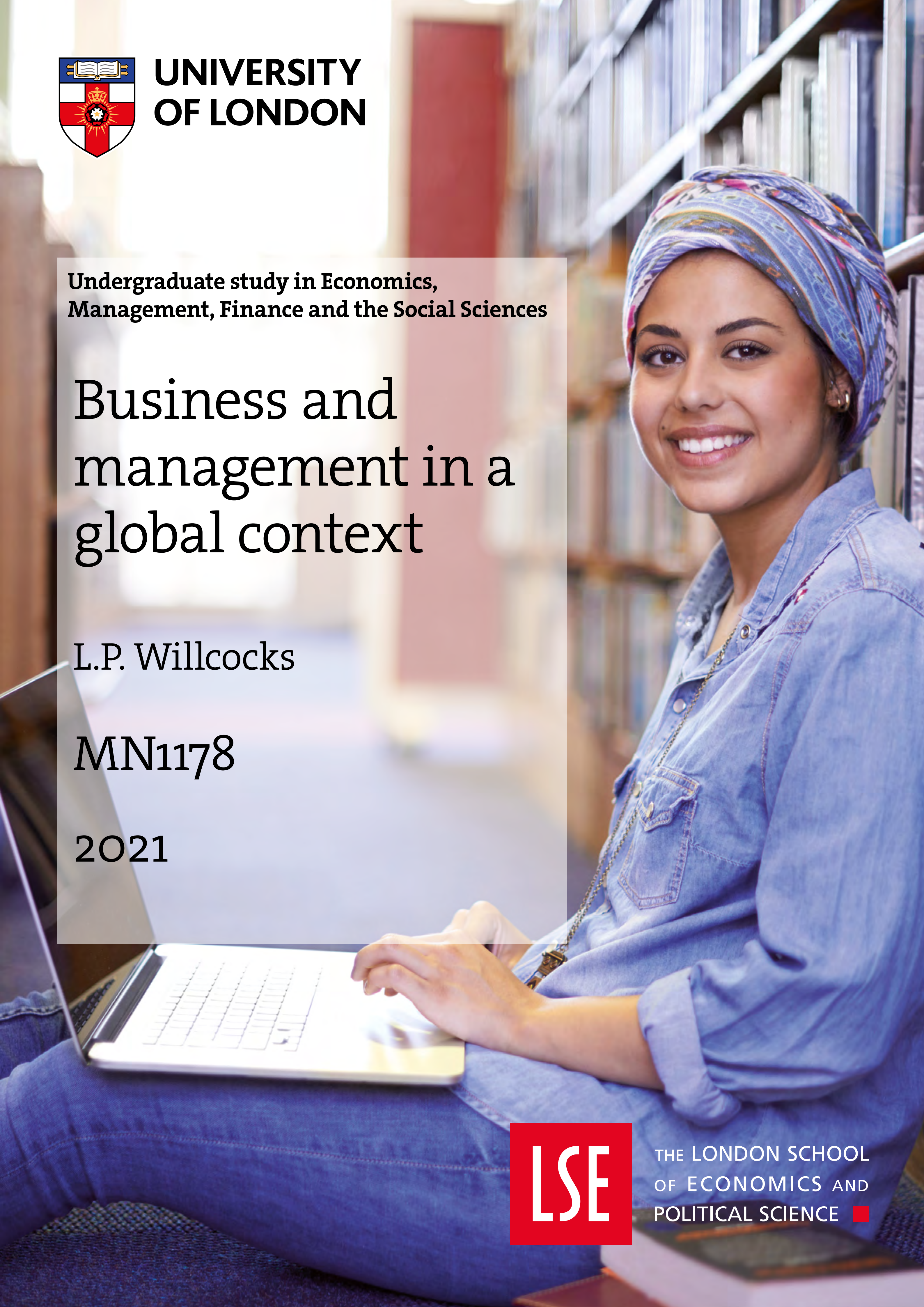

UNIVERSITY OF LONDON

Undergraduate study in Economics, Management, Finance and the Social Sciences

Business and management in a global context

L.P. Willcocks

MN1178

2021

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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This subject guide is for a 100 course offered as part of the University of London undergraduate study in Economics, Management, Finance and the Social Sciences. This is equivalent to Level 4 within the Framework for Higher Education Qualifications in England, Wales and Northern Ireland (FHEQ).

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THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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This is one of a series of subject guides published by the University. We regret that due to pressure of work the author is unable to enter into any correspondence relating to, or arising from, the guide. If you have any comments on this subject guide, favourable or unfavourable, please use the form at the back of this guide.

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Introduction

1.1 Route map to the guide

The guide and course are structured in four parts. The first provides an introduction to the global business environment and covers trends towards globalisation (Chapter 1) and the formal and informal institutions of countries. In particular, we focus on international political, economic, legal, cultural, and social diversity (Chapters 2 and 3). The subject guide provides activities that will help you to pick out the management challenges and implications, not least that of corporate social responsibility when operating on the global stage.

The second part gives an overview of why international trade takes place, why firms invest abroad (Chapter 4), the cross-border institutions that exist such as the IMF, World Bank and regional economic blocs (Chapter 5) and how the global financial system functions (Chapter 6).

These first two parts provide the context of international business while Part 3 gives insight into how to analyse that context to arrive at competitive international strategies (Chapters 7 and 8), enter markets and evolve (Chapter 9) and develop marketing and R&D strategies (Chapter 10).

The fourth part focuses on major operational areas of an international business, namely designing the organisation (Chapter 11), global sourcing and supply chain management (Chapter 12), establishing global information systems (Chapter 13), managing human resources (Chapter 14). The updated new syllabus also includes two areas that have become increasingly high profile in an uncertain, dynamic global business environment. These are international project management (Chapter 15) and global digital management, including digital transformation (Chapter 16).

1.1.1 How to use this guide and hours of study

The advice normally given to students on this programme is that if they are studying one course a year, they should allow at least six hours of study a week. This subject guide provides detailed chapters to save you time, since there are too many books on this subject to read and absorb in the time, while the articles in refereed journals tend to be over-specialised. There are also two essential texts designed to distill the fundamentals of managing international business. Willcocks (2021a) is very strong on international business, institutions, global context and global business strategy, and focuses on Parts 1, 2, and 3 of the syllabus. The other, complementary, text by Willcocks (2021b) covers Part 4 of the syllabus, and concentrates on global business management. There is also some additional reading, but this has been kept to a minimum.

You should read each chapter of the subject guide once, then work through it methodically a second time, doing the activities as they appear. This will involve reading pages from the Essential reading texts and articles prescribed for the chapter, but might also involve looking at an article, or a case study provided in the textbook or on the virtual learning environment (VLE). There are many activities and sample examination questions. Do not skip these! They are a key part of your learning. Where you are asked questions, write your answers down carefully and in detail so you can revise from them at a later point, before any examination. Each chapter includes a set of learning outcomes. These set out what you should have learned from the Essential reading, engaging with the activities and the chapter of the subject guide. You should use these to assess your own progress and if necessary revisit some of the material to ensure you have made the necessary progress.

1.2 Introduction to the subject area

As a manager faced with this complexity, dynamism, unpredictability, and diversity, you face the difficult challenge of devising strategies that will work internationally, in different parts of the globe, plan entry strategies for new markets, and decide who you need to establish alliances with and how your strategy is to evolve. You then need to work at the detail of managing, specifically designing structure and organisation, devising sourcing and supply chain arrangements, establishing information systems that perform globally, and creating distinctive arrangements for managing international human resources. Increasingly, in the face of change, you will need to draw upon international project management capability. Meanwhile, competitive forces and available technologies pressure you to move ever more towards becoming a digital business.

As a student, you will find understanding and analysing international business and making managerial judgements to be full of fresh challenges, and you will also find that studying this subject area provides insights and gives you the analytical equipment and knowledge to begin to perform in a business that operates globally.

1.3 The syllabus

Part 1: Introduction to the global business environment

Perspectives on globalisation and international business: trends and drivers of globalisation, foundations of global trade and finance, overview and framework for understanding the global economy, the development of the multinational enterprise (MNE), debates on the nature and impacts of impacts of globalisation, and the implications for managing international business. Recent trends: deglobalisation, 'slowbalisation", global systemic risks. Future challenges, opportunities and directions for international businesses in changing global contexts.

Political, economic and legal environments: common and diverse; political, economic and legal; formal and informal institutions and how they contextualise and shape management practices and the conduct of business. This includes comparing national economies, regional integration, international organisations, and relationships between government and business.

Culture society, ethics and corporate social responsibility: informal institutional influences of social, cultural, ethical and religious factors and how these play into globalisation, rendering a necessary focus on balancing global, regional and local factors when conducting business internationally. The chapter discusses differences and types of culture, language and religion and the different types of ethics and attitudes towards corruption and corporate social responsibility to be found. It also deals with corporate social responsibility and corporate sustainability practices.

Part 2: Business across borders: the foundations

International trade and investment: classical and modern trade theories, national institutions and international trade, government intervention and free trade, patterns in global trade; rationale for, and challenges of, foreign direct investment.

Global and regional integration and multilateral organisations: the different levels of regional integration found across the globe, and the benefits and challenges of regional integration. It describes regional integration in Europe, the Americas, Asia and Middle East and North Africa.

The global financial system: the international capital market, foreign exchange markets and related institutions., including evolution and roles of the WTO, World Bank and IMF.

Part 3: International business strategy

Strategy and the enterprise in international contexts: introduction to international business strategy. Detailed assessment of the PESTEL framework and Ghemawat's culture, administration, geography, economy (CAGE) framework as a basis for analysing the international environment for a firm, types of strategy commonly pursued in international business, how such strategies evolve, Ghemawat's aggregation, arbitrage and adaptation (AAA) framework as a basis for designing strategy for international contexts.

Competitive strategy for international business: concepts of corporate and business strategy, how firms compete through competitive positioning and resource-based approaches, dynamics of competition, the global, regional and local dimensions in strategy, Porter's five forces, value chain and generic strategies frameworks, resource-based and institution-based approaches to international competitiveness. Critical assessment of applicability and limitations of these frameworks and approaches. Bringing environment and strategy together – which strategy, and when; new debates on strategy.

Entry strategies, alliances and evolution: foreign entry strategies, including where, when and how to enter international markets, the strategies to be pursued, the contextual factors that need to be taken into account, the role of strategic alliances in entering and positioning in international markets, the role of Foreign Direct Investment (FDI), how to organise operations given the choices made, evolving the global strategy, including growth by acquisition.

Part 4: International business management

Organisation of international business: different types of organisational structure and how they relate to strategy, processes, institutions and culture. Includes divisionalisation, matrix and hybrid structures, organisational change issues, organisational architecture and integrating the international business, need for a contingency approach.

Marketing and R&D: international marketing assessment, international consumers, developing marketing strategy, customer lifecycle marketing, modes of differentiation, the 4 'P's mix of place, price, product and promotion, and global branding, new product and market development, distribution and supply chain issues, R&D and sources of innovation including R&D offshoring.

Global sourcing of production and services: global sourcing choices and drivers, make-or-buy decisions, locating production, logistics concepts and developments, strategic sourcing issues of emerging locations and country attractiveness. Offshoring and nearshoring production and services, sourcing options, decisions, risk and management for global business and IT services. Managing across the outsourcing lifecycle.

Global information systems management: business strategy and IS alignment from strategy to operations, organising for internal IT performance – structure, staffing and capabilities, the role of IT infrastructure and its management, retained capabilities, global implementation of IS projects, managing global enterprise IT architecture.

Managing international finance: exchange rates and markets for currencies, types of risk, and techniques for risk management, managing exchange rates in the context of a changing international monetary system, roles of the IMF and the World Bank. Cryptocurrencies: will their time come?

International dimensions of human resources management: approaches to managing people, the main functions of the HR department, Types of international staffing policy, global pay and incentivisation practices, managing expatriates and multinational workforces, recruitment, selection, training, development, appraisal, performance management, international labour relations, impact of 2020–21 crises on work. Automation and international human resources management.

International project and change management: Definitions. The principles for effective project management. Why projects fail. Methodologies – uses and limitations. Why international projects are different, distinctive risks and their management in international projects, action principles for effective international project management. Why change management challenges in international contexts, taking a holistic approach to change management.

Moving to global digital business: Major emerging digital technologies, developing a digital business model, designing for digital – the building blocks, achieving digital transformation – practices and cases.

1.4 Aims and objectives of this course

This course specifically aims to:

- Give you a research-based grounding in the shifting contexts of, and changing priorities in, international business including globalising trends, formal and informal institutions, the political, economic, social, technological and legal issues and the resultant diversity of international business. Specifically takes into account the impacts of the 2020–21 pandemic and economic crises.
- Prepare you to be able to discuss cultural, ethical and social issues for international business and suggest policies of corporate social responsibility and sustainable business practices.
- Provide an introduction to and develop your ability to assess international trade and investment, multilateral organisations and regional integration and the global financial system.
- Prepare you to be able to discuss how firms develop international business strategies, enter markets and alliances, and operate and manage on the global stage.

- Give insight through frameworks, studies and examples of how businesses manage marketing and research & development, organisational structure and architecture, sourcing and the supply chain, exchange rates, information systems and human resources, in different parts of the globe, globally, regionally and domestically.
- Prepare you to understand and assess project and change management practices in an international context
- Provide an introduction to the major emerging digital technologies, and how to manage these into operation and become digital businesses internationally.
- Overall, give you insight into the contexts of international business and enable you to work within these contexts to make judgements on strategizing and managing operations in the global.

1.5 Learning outcomes for the course

At the end of the course and having completed the essential reading and activities students should:

- demonstrate knowledge of, and the ability to assess, core institutions of international business and how firms manage on the global stage
- assess regional, cultural and institutional differences in how business is conducted globally
- apply core understandings, frameworks and management principles to specific business contexts
- formulate choices and decisions in international business strategy and operations
- operate as an informed employee in an international firm.

1.6 Overview of learning resources

1.6.1 Essential reading

The Essential reading consists of two texts, which between them cover the whole syllabus:

Willcocks, L. *Global business: strategy in context.* (Stratford: SB Publishing, 2021) [ISBN 9780995682085]. This text covers subject guide Chapters 1, 2, 3, 4, 5, 7, 8 and 9 of the subject guide. Available directly from the publisher: www.sbpublishing.org (referred to in this guide as Willcocks 2021a)

Willcocks, L. *Global business: management.* (Stratford: SB Publishing, 2021) [ISBN]. The text covers Chapters 6, 10, 11, 12, 13, 14, 15 and 16 of the subject guide. Available directly from the publisher: www.sbpublishing.org (referred to in this guide as Willcocks 2021b)

You will find that all of the points covered in the subject guide chapters will be covered in these two books, although there are also a variety of other texts recommended as Essential reading for specific chapters. Further reading, from the journal articles, books and the weekly sources mentioned below will give you more arguments, examples and detail that can greatly enhance your knowledge and understanding, as well as, more pragmatically, help you improve your examination answers.

Check the VLE regularly for updated guidance on readings and case studies. There are several Essential journal articles, listed below.

Journal articles: Essential

Abbasi, N., I. Wajid,. Z. Iqbal and F. Zafar ‘Project failure case studies and suggestion’, *International Journal of Computer Applications* 86(6) 2014, pp.34–39.

Bingham, C., K. Eisenhardt and N. Furr ‘Which strategy, when?’, *Sloan Management Review* 53 2011, pp.71–78.

Cantwell, J. et al. ‘An evolutionary approach to understanding international business activity’, *Journal of International Business Studies* 41(4) 2010, pp.567–86.

Collings, D., H. Scullion and P. Dowling ‘Global staffing: a review and thematic research agenda’, *International Journal of Human Resources Management* Special issue 20(6) 2009, pp.1253–72.

Cullen, S., P. Seddon and L. Willcocks ‘Managing the outsourcing lifecycle imperative’, *MISQ Executive* 4(1) 2005, pp.229–46.

Davies, H. and P. Ellis ‘Porter’s competitive advantage of nations’, *Journal of Management Studies* 37(8) 2000, pp.1189–1215.

Decker, C. and T. Mellewigt ‘Thirty years after Michael E. Porter’, *Academy of Management Perspectives* 21(2) 2007, pp.41–55.

Ghemawat, P. ‘Managing differences: the central challenge of global strategy’, *Harvard Business Review* 85(3) 2007, pp.58–68.

Ghemawat, P. ‘Distance still matters: the hard reality of global expansion’, *Harvard Business Review* 79(8) 2001, pp.137–47.

Goold, M. and A. Campbell ‘Do you have a well-designed organisation?’, *Harvard Business Review* 80(3) 2002, pp.117–24.

Gottfredson, M., R. Puryear and S. Phillips ‘Strategic sourcing’, *Harvard Business Review* 83(2) 2005, pp.132–39.

Kettinger, W., D. Marchand and J. Davis ‘Designing enterprise IT architectures to optimise flexibility and standardisation in global business’, *MISQ Executive* 9(2) 2010, pp.95–113.

Luftman, J., H. Zadeh, B. Derkesen et al. ‘Key information technology and management issues 2011–12: an international study’, *Journal of Information Technology* 27(3) 2012, pp.198–212.

Malhotra, N. and C. Hinings ‘An organisational model for understanding internationalisation processes’, *Journal of International Business Studies* 41(2) 2010, pp.330–49.

Nelson, R. R. (2007), ‘IT project management: Infamous failures, classic mistakes, and best practices’, *MIS Quarterly Executive*, 6(2).

Peng, M. ‘The resource-based view and international business’, *Journal of Management* 27 2001, pp.803–29.

Peng, M., D. Wang and Y. Jiang ‘An institution-based view of international business strategy’, *Journal of International Business* 39 2008, pp.920–36.

Porter, M. ‘What is strategy?’, *Harvard Business Review* 74(6) 1996, pp.61–78.

Trent, R. and R. Monczka ‘Achieving excellence in global sourcing’, *Sloan Management Review* 47(1) 2005.

Willcocks, L. ‘Can business recover from the crisis? Assessing scenarios, riding trends.’ *Journal of Financial Transformation* 52(1) 2021, pp.94–101.

Willcocks, L. ‘Take the outsourcing health check’, *Professional Outsourcing Magazine* 7 2011, pp.6–12.

1.6.2 Further reading

Please note that as long as you read the Essential reading you are then free to read around the subject area in any text, paper or online resource. You will need to support your learning by reading as widely as possible and by thinking about how the principles apply in the real world. To help you read extensively you have free access to the VLE and University of London Online Library (see below).

Business and management in a global context is a fast moving subject to study. Therefore, it is particularly important that you keep up with the most recent developments. You can do this by regularly reading such sources as *The Economist*, which has weekly news and regular, relevant special studies; the *Financial Times*, which provides daily world commentary and also has a backlog and regular regional and theme special issues; and the *Wall Street Journal*, which also provides detailed daily world commentary. The two daily newspapers have regional editions.

You should also identify more regionally based weekly business journals and magazines that will provide insightful articles and good illustrative examples of the events and practices you are studying in this course. Do not forget to keep detailed notes on what you find from such sources for revision purposes.

There are numerous books available on international business, far too many for you to be able to read. However, here are three of the most useful ones that we occasionally refer to in the subject guide:

Collinson, S., R. Narula, and A. Rugman *International business.* (Harlow: Pearson Education, 2020) eighth edition [ISBN 9781292274157]. This is strong on international business strategy and gives the most detailed coverage of regions.

Hill, C. *International business: competing in the global marketplace*. (New York: McGraw Hill, 2021) 13th edition [ISBN 9781260575866]. This gives another perspective on international business from a book with a greater focus on economics and a more North American perspective.

Peng, M. and K. Meyer *International business*. (Andover: Cengage Learning, 2019) third edition [ISBN 9781473758438]. This gives a strong European perspective.

Journals

There are also many journals covering international business and management. Some will be too research based and advanced for your purposes. It is also best to focus on the more recent articles, written within the last three years. The main journals for additional articles on globalisation, business strategy and management are:

- *Academy of Management Perspectives* (formerly the *Academy of Management Executive)*
- *Academy of Management Review*
- *Strategic Management Journal*
- *Long Range Planning*
- *Journal of Management Studies*
- *Journal of International Business Studies*
- *Journal of Management*
- *Management Information Systems Quarterly Executive*
- *Organization Science*
- *Management International Review*
- *Harvard Business Review*
- *Sloan Management Review*
- *California Management Review*.

Full list of Further reading

For your ease of reference, here is a list of all the further reading for this course. Many of these papers and books are listed as further reading in the relevant chapters. There are also additional useful references, if you wish to explore a topic even further.

AMA: The definition of marketing. (American Marketing Association, 2007). Available at: www.ama.org/the-definition-of-marketing-what-is-marketing/

Ansoff, H. *Corporate strategy*. (London: Penguin, 1988) [ISBN 9780140091120].

Barney, J. 'Is the resource-based view a useful perspective for strategic management research?', *Academy of Management Review* 26 2001, pp.41–56.

Bartlett, C.A. and S. Ghoshal *Managing across borders: the transnational solution.* (Boston: Harvard Business School Press, 2002) second edition [ISBN 9781578517077].

Bhagwati, J. *In defense of globalization.* (New York: Oxford University Press, 2007) [ISBN 9780195330939].

BMG Research *Factors in project success*. (Birmingham, UK: BMG Research, 2014).

Buckley, P. et al. 'The internalisation theory of the multinational enterprise: a review of the progress on a 30-year research agenda', *Journal of International Business* 40 2009, pp.1563–80.

Bungay, S. 'Five myths about strategy', *Harvard Business Review* 19 April 2019.

Bughin, J., J. Deakin and B. O'Beirne. 'Digital transformation: improving the odds of success', *McKinsey Quarterly* October 2019.

Caligiuri, P., H. De Cieri, D. Minbaeva, A. Verbeke and A. Zimmerman 'International HRM insights for navigating the COVID 10 Pandemic: implications for future research and practice', *Journal of International Business Studies* 2020 51 pp.697–713.

Chandler, A. *Strategy and structure*. (Cambridge: MIT Press, 1962) [ISBN 9780262530095] p.13.

Chang, H. *Kicking away the ladder.* (London: Anthem Press, 2003).

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Cullen, S., M. Lacity, and L. Willcocks *Outsourcing – all you need to know.* (Melbourne, Australia: White Plume, 2014).

Dicken, P. *Global shift: mapping the changing contours of the world economy*. (London: Sage, 2010) sixth edition [ISBN 9781849207676].

Doh, J., P. Rodriguez, K. Uhlenbruck, J. Collins, and L. Eden 'Coping with corruption in foreign markets', *Academy of Management Executive* 17(3) 2003, pp.114–29.

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Dunning, J. and S. Lundan *Multinational enterprises and the global economy*. (Cheltenham: Edward Elgar Publishing, 2008) second edition [ISBN 9781847201225].

Earl, M. (ed.) *Information management: the organisational dimension*. (Oxford: Oxford University Press, 1996).

Fonstad, N. and M. Subramani 'Building enterprise alignment: a case study', *MISQ Executive* 8(1) 2009, pp.31–41.

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Friedman, T. *The world is flat: the globalized world in the twenty-first century*. (London: Penguin, 2007) third edition [ISBN 9780141034898].

Ghemawat, P. 'Developing a global strategy' in Ghemawat, P. *Strategy and the business landscape*. (Boston: Pearson, 2008) third international edition [ISBN 9780132457200].

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Gurbaxani, V. and D. Dunkle, 'Gearing up for successful digital transformation', *MISQ Executive*, 18(3) 2019 pp.209–220.

Hall, P. and D. Soskice (eds) *Varieties of capitalism*. (Oxford: Oxford University Press, 2001) [ISBN 9780199247752].

Haskel, J. and S. Westlake *Capitalism without capital.* (Princeton: Princeton University Press, 2018).

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Johnson, G., R. Whittington and K. Scholes *Exploring strategy*. (London: Financial Times/Prentice Hall, 2010) ninth edition [ISBN 9780273737025].

Jones, A. *Globalisation: key thinkers*. (Cambridge: Polity, 2011).

Khan, R. and K. Spang *Critical success factors in international projects*. Sixth International IEEE Conference on Data Acquisition and Advanced Computing Systems, 15–17 September 2011, Prague, Czech Republic, www.researchgate.net/publication/220798045_Critical_success_factors_for_international_projects

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Yin, E. and C. Choi 'The globalization myth', *Management International Review* 45(1) 2005, pp.103–20.

1.6.3 Online study resources

In addition to the subject guide and the Essential reading, it is crucial that you take advantage of the study resources that are available online for this course, including the VLE and the Online Library.

You can access the VLE, the Online Library and your University of London email account via the Student Portal at: http://my.london.ac.uk

You should have received your login details for the Student Portal with your official offer, which was emailed to the address that you gave on your application form. You have probably already logged in to the Student Portal in order to register! As soon as you registered, you will automatically have been granted access to the VLE, Online Library and your fully functional University of London email account.

If you have forgotten these login details, please click on the 'Forgotten your password' link on the login page.

The VLE

The VLE, which complements this subject guide, has been designed to enhance your learning experience, providing additional support and a sense of community. It forms an important part of your study experience with the University of London and you should access it regularly.

The VLE provides a range of resources for EMFSS courses:

- **Electronic study materials**: All of the printed materials which you receive from the University of London are available to download, to give you flexibility in how and where you study.
- **Discussion forums**: An open space for you to discuss interests and seek support from your peers, working collaboratively to solve problems and discuss subject material. Some forums are moderated by an LSE academic.
- **Videos**: Recorded academic introductions to many subjects; interviews and debates with academics who have designed the courses and teach similar ones at LSE.
- **Recorded lectures**: For a few subjects, where appropriate, various teaching sessions of the course have been recorded and made available online via the VLE.
- **Audiovisual tutorials and solutions**: For some of the first year and larger later courses such as Introduction to Economics, Statistics, Mathematics and Principles of Banking and Accounting, audio-visual tutorials are available to help you work through key concepts and to show the standard expected in exams.
- **Self-testing activities**: Allowing you to test your own understanding of subject material.
- **Study skills**: Expert advice on getting started with your studies, preparing for examinations and developing your digital literacy skills.

Note: Students registered for Laws courses also receive access to the dedicated Laws VLE.

Some of these resources are available for certain courses only, but we are expanding our provision all the time and you should check the VLE regularly for updates.

Making use of the Online Library

The Online Library (http://onlinelibrary.london.ac.uk) contains a huge array of journal articles and other resources to help you read widely and extensively.

To access the majority of resources via the Online Library you will either need to use your University of London Student Portal login details, or you will be required to register and use an Athens login.

The easiest way to locate relevant content and journal articles in the Online Library is to use the **Summon** search engine.

If you are having trouble finding an article listed in a reading list, try removing any punctuation from the title, such as single quotation marks, question marks and colons.

For further advice, please use the online help pages (http://onlinelibrary.london.ac.uk/resources/summon) or contact the Online Library team: onlinelibrary@shl.london.ac.uk

Other web resources

Various websites are cited in this subject guide. Unless otherwise stated, they were accessed in April 2021. We cannot guarantee, however, that they will stay current and you may need to perform an internet search to find the relevant pages.

1.7 Examination advice

Important: the information and advice given here are based on the examination structure used at the time this guide was written. Please note that subject guides may be used for several years. Because of this we strongly advise you to always check both the current Programme regulations for relevant information about the examination, and the VLE where you should be advised of any forthcoming changes. You should also carefully check the rubric/instructions on the paper you actually sit and follow those instructions.

1.7.1 Format of the examination

The examination is three hours long and you are normally required to answer **four** questions from a choice of **eight**.

The examination is three hours long, and you are normally required to answer **four** questions from a choice of **eight**.

Remember, it is important to check the VLE for:

- up-to-date information on examination and assessment arrangements for this course
- where available, past examination papers and *Examiners' commentaries* for the course which give advice on how each question might best be answered.

Notes

Part 1: Introduction to the global business environment

Notes

Chapter 1: Perspectives on globalisation and international business

1.1 Introduction

Welcome to international management. Managing is essentially about getting work done through others. Historically, many have seen management as quite a 'hands-off' task, involving thinking, the scientific and systematic sifting of evidence, making decisions based on sufficient objective information, and then planning, controlling, coordinating and monitoring outcomes. All this is undoubtedly part of management. But, starting in the 1970s, Henry Mintzberg began to demonstrate that managing is also, at the same time, an art involving vision and creative insights, a craft involving experience and practical learning and, ultimately, a practice aimed at getting effective results. In fact, study after study has supported Mintzberg's views. It turns out that when you manage, typically you will experience unrelenting pace, brevity and variety of the activities you undertake and fragmentation and discontinuity in the job. You will need an orientation to action, will tend to favour informal and spoken forms of communication, and you will deal a lot with colleagues and associates (i.e. sideways as much as up and down the organisation's hierarchy). And your soft skills in motivation, negotiation and persuasion will be as important as any formal control mechanisms you might have available.

In this course we explore management, but with the added complexity of moving management onto the world stage. Suddenly you will discover that what works in your own organisation and in your own country might not work as well, if at all, abroad. In this course you will learn about the factors that make managing internationally similar in many respects to managing in your home country, but very different in many others. In the first six chapters you will find out how the formal and informal institutions of the international community, regions and countries make the job of managing very much more sophisticated. In Chapters 7 to 10 you will learn how international managers deal with these contextual factors when they devise and implement strategies to compete, invest and operate in different regions and countries. And in Chapters 11 to 16 we will have a more detailed look at the international challenges facing managers responsible for devising organisational structure, global sourcing, information systems, human resources, international project management, global digital management and how they go about their tasks.

In this chapter we are going to start by looking at a major phenomenon that managers have to live with if operating internationally, that of globalisation. Globalisation can be defined as the shift towards a more integrated and interdependent world economy. In other words, the world has been moving away from self-contained national economies, towards an interdependent, integrated global system. However, as we shall see, there has been a slowing down of this process, and in some cases even a reversal in recent years, worsened by the 2020–21 pandemic and economic crisis. Historically, a major part of globalisation has been increased international trade and foreign direct investment. International trade occurs when a company exports goods or services to consumers in another country. Foreign direct investment (FDI) occurs when a company invests resources in business activities outside its home country. From a business perspective, you can think of globalisation in terms of both markets and production. The globalisation of markets refers to the merging of historically distinct and separate national markets into one huge global marketplace. The globalisation of production refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production such as land, labour and capital.

What has all this meant for business? Consider the Dell notebook and its global journey, described in Friedman (2005). Even back then its components were sourced from over 30 countries around the world! What does all this mean for you and me? Consider my own day. I wake up in the United Kingdom in a bed made by Sweden's Ikea, get dressed in a shirt made in India and a pair of US Levi's jeans that were produced in China. After putting on my Taiwanese-made trainers, and drinking an Italian-style cappuccino, I drive to work in my Japanese Honda that was manufactured in the UK. On the way to a client headquartered in the Netherlands, but with operations in the UK, I talked to my friend on a Nokia cell phone designed in Finland, about getting together later for Spanish-style tapas and Tiger beer from Singapore. As you can see, my day has already been filled with the effects of globalisation. But there are multiple other effects. As examples only, is my job safe? Are there new job prospects? Where is the next technological change going to come from? Is globalisation adversely affecting my environment?

This chapter introduces you to globalisation, the trends towards globalisation and its main drivers. We explore the major debates for and against globalisation, and whether companies wishing to operate internationally can work on the basis of the assumption that the world is flat, or something else. We look at the implications of globalisation for companies wanting to extend themselves further globally. We also take into account the short-term and long-term impacts of the 2020–21 crisis on international business.

1.1.1 Aims of the chapter

The aims of this chapter are to:

- introduce the major attributes of globalisation the global economy
- identify the major trends and players in the global economy
- present the major debates around globalisation and its impacts, and the advantages and disadvantages from different stakeholder perspectives
- pinpoint the implications of globalisation for international and domestic businesses
- Assess the short and long-term impacts of the pandemic and economic crises of 2020–21 on how international business can be conducted.

1.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define the major characteristics of globalisation
- assess the global economy and its broad trends
- explain the major trends in globalisation, and the major players in the globalisation process

- enter into the major globalisation debates and assess under what conditions and for whom globalisation can be considered an advantage or disadvantage
- describe the implications of globalisation for companies operating internationally
- assess the short- and long-term implications for international business arising from the COVID-19 and economic crises, and emerging global trends, including de-globalisation.

1.1.3 Essential reading

Ghemawat, P. 'Distance still matters: the hard reality of global expansion', *Harvard Business Review* 79(8) pp.137–47.

Willcocks, L. *Global business: strategy in context*. (Stratford-upon-Avon, UK: SB Publishing, 2021a), Chapters 1 and 7.

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1.1.4 Further reading

Willcocks, L. *Global business: management.* (Stratford-upon-Avon, UK: SB Publishing, 2021b), Chapter 1, sections 1.2, 1.5. and 1.6.

1.1.5 References cited

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1.1.6 Synopsis of chapter content

Trends and drivers of globalisation, foundations of global trade and finance, overview and framework for understanding the global economy, the development of the multinational enterprise (MNE), debates on the nature and impacts of impacts of globalisation, impact of COVID-19 and the 2020–21 economic crisis, emerging trends and the implications for managing international business.

1.2 What is globalisation?

What is globalisation and what are the challenges it raises for business organisations worldwide? Some identify globalisation with the accelerated spread of communication and transportation technology. Others identify it with the rising power of multinational enterprises (MNEs) and increased inequality in the world. Some experience it as increased competition for jobs, especially for low skilled workers. Others emphasise how globalisation is a force eliminating differences between distinctive cultures and identities, while still others argue this is exaggerated and the world is still defined by national boundaries, and others see the world moving rapidly towards a homogenous plain without national boundaries. Defining globalisation has big implications; how it is explained to the public influences how the idea is received.

Globalisation involves increasing amounts of cross-border trade, with traditional distances between nations lessening, due to advances in transportation and telecommunications technology. Globalisation does involve the rise of MNEs and has seen the globalising of markets and production, which has seen increased competition for jobs and between nations. Globalisation has also seen some erosion of differences among distinctive national cultures and identities, but, as we shall see below and in Chapter 7, the extent may be exaggerated. Companies that treat all markets the same invariably learn the limits of this approach.

Globalisation has also seen the development of international bodies to try to deal with all this increased interconnectedness. There are now international governing bodies such as GATT (General Agreement on Tariffs and Trade), which has been succeeded by the WTO (World Trade Organisation) that hold the key to many economic decisions affecting the world and have power over nations akin to a political body or national government. These governing bodies symbolise the interconnectedness of the world just as the United Nations did after the end of the Second World War. The goal of the International Monetary Fund is to maintain order in the international monetary system. As we will see in later chapters, the World Bank promotes economic development by making loans to cash-strapped nations wishing to make significant infrastructure improvements like building dams or roads. These international organisations influence businesses and communities wishing to collaborate with other countries.

Activity

Read Willcocks (2021a) pp.13–16, sections 1.1 to 1.2. Decide for yourself:

1. What is a good definition of globalisation?
2. How would you define international business?

1.3 Trends towards globalisation

As Willcocks (2021a) Chapter 1 points out, globalisation is hardly new. People have been trading internationally for several thousands of years. However, the last 150 years have seen an intensification of globalisation, in what Jones (2010) depicts as two waves, arising in each case from a combination of long-term trends and pendulum swings.

Activity

Read Willcocks (2021a) pp.16–20, Section 1.3.

1. Assuming there have been three waves of globalisation what are the dates for each of these waves? See Willcocks (2021a), p.16.
2. What is 'slowbalisation' and when did it start? Is it still with us? What are the indicators? See Willcocks (2021b) Chapter 1, section 1.2 for more on this subject.
3. What does *The Economist*, 5 May 5 2020 mean by the phrase 'the 90% economy'? Look this up by browsing on the internet, and also in Willcocks (2021b) section 1.2.

In the 1970s and 1980s globalisation as international trade was largely a matter for developed economies in the triad of North America, Western Europe and Japan. However, globalisation accelerated dramatically in the 1990s. Emerging economies joined much more in global trade, particularly the largest in terms of population, namely Brazil, Russia, India and China – the so-called BRIC countries. An emerging economy is one that has only recently established institutional frameworks that facilitate international trade and investment. Typically they have low- or middle-level incomes among their population and above average economic growth compared to other nations. In the 1990s world output grew by 23 per cent over the decade, global trade expanded by 80 per cent and the total flow of FDI increased fivefold.

Gross Domestic Product (GDP) is the sum of value added by resident companies, households and governments operating in an economy. In the first decade of the 21st century, world GDP, cross-border trade and per capita GDP all grew to new, unprecedented levels. All this was before the 2008–09 global economic crisis, which led to global output, trade and investment plummeting and unemployment rising. From mid-2009 there was renewed confidence after massive government intervention in developing economies, but economic recovery has been slow in developed economies, while some emerging economies have rebounded faster. Overall, the second wave has become less steep from 2010–12 as globalisation has slowed down.

What has been driving globalisation? Two macro factors are important: first, the decline in trade and investment barriers since the Second World War, and second, technological change, specifically dramatic improvements in communication, information processing and transportation technologies. Hill (2021) suggests that four trends have been particularly important:

- **Changes in world output and world trade**: In the 1960s, the USA dominated the world economy and world trade picture. Today, this picture has changed. In 2008, the USA accounted for only about 20 per cent of world economic activity. Other developed countries saw their share of global economic activity decline over time as well. Developing nations saw the opposite trend – their share of world output has been rising, and by 2025 they are expected to account for more than 60 per cent of world economic activity, with today's 'rich' nations declining from 55 per cent in 2018, to 38 per cent in 2025. Countries like China, Thailand and Indonesia have emerged as global economic players. Countries such as the USA, the UK, Germany and Japan, which were among the first to industrialise, will continue to see their standings in world exports and world output slip, while developing nations like China, India, South Korea and Thailand see their economies and roles in global trade and investment increase.
- **Foreign direct investment**: In the 1960s, the USA accounted for over 66 per cent of worldwide foreign direct investment flows. Today, investments by developing nations are on the rise, while the stock, or total cumulative value, of foreign investments by rich industrial countries is falling. Developing nations like China have also become important destinations for foreign direct investment flows. The share of total stock of foreign direct investment by the world's six most important sources – the USA, the UK, Japan, Germany, France, Netherlands and developing countries – changed significantly from 1980 to 2007. In particular, the share of the USA noticeably declined (from 38 per cent to 18 per cent), and the world's developing countries increased from less than 1 per cent to 15 per cent.

- Increased growth in cross-border flows of foreign direct investment is very noticeable in the official figures, reaching an all-time high in 2007. One can also see the rising importance of developing nations as destinations for FDI. Chapter 4 of this guide deals with FDI in detail.
- **Types of companies**: The global economy has also shifted in terms of the types of companies that are involved. A multinational enterprise is any business that has productive activities in two or more countries. Since the 1960s, two important trends have emerged. First, an increase in the number of non-US multinationals. Multinational enterprises from France, Germany, Britain and Japan have become more important and there has been a notable decline in the role of US companies. By 2017, only 540 of the top 2000 global firms were US-based multinationals, a drop of some 236 in 15 years. Companies from developing countries such as China and South Korea have also emerged as important players. The second trend is the growth in the number of mini-multinationals. China's Lenovo, for example, acquired IBM's PC division in 2004, in an effort to become a global player in the PC industry, and moved its headquarters to the USA as part of its strategy. Traditionally, global markets have been the venue for large companies, but today, thanks to advances in technology like the internet, international sales can account for a significant share of revenues for small companies too.
- **Change in world order**: The collapse of Russian communism has brought about new opportunities in Eastern Europe, and China's economic development and enormous population presents huge opportunities for companies. Mexico and Latin America have also emerged both as new markets and as production locations. And China and India, for example, are now home to a number of companies that either are or could become significant players in their global industries. This world order changed again as we moved into the third decade of the 21st century. For example, some states have moved to more authoritarian government with state involvement in business. Several South American countries have been attracting more inward investment, while others have suffered economic mismanagement and are less attractive markets, and targets for FDI.

Willcocks (2021a) Chapter 1, pp.16–20, section 1.3, and Chapter 7 are useful for describing the 2020–21 pandemic and economic crisis and its short- and long-term impact on international business.

Activity

Read Willcocks (2021a) Chapter 1, sections 1.1, 1.2 and 1.3, pp.13–20, and answer the following questions:

1. What have been the four main trends towards globalisation since the 1980s?
2. What new trends emerged from around 2015?
3. What do you see as the main lessons arising from the 2020–21 crisis for international businesses? See Willcocks (2021b) sections 2.5 and 2.6 for more ideas.
4. What new global trends do international businesses have to plan for from 2021? (See Willcocks, 2021a) pp.196–200, sections 7.6 and 7.7.

1.4 The globalisation debates

What does the global economy look like in the third decade of the 21st century? The world is moving towards a more global economic system but, as Willcocks (2021a) Chapter 7, section 7.5 p.196 points out, this interdependency creates new types of risk. Proponents of globalisation, such as Bhagwati (2007), focus on its benefits. Supporters argue that globalisation means lower prices, more economic growth and more jobs. But critics worry that globalisation will cause job losses, damage the environment and create cultural imperialism. Ian Goldin and Mike Mariathasan (2016), in their book *The butterfly defect*, also discuss how globalisation creates systemic risks. These are adverse consequences arising from the 'butterfly effect' where, in an inter-connected world, small changes in condition in one system or part of the world can create major differences in a seemingly remote and unconnected system. They discuss financial sector risks; risks in supply chains and infrastructure; as well as pandemic, health, ecological, and social inequality risks.

Four major areas of debate recur:

1. **Jobs and income**: Critics of globalisation worry that jobs are being lost to low-wage nations. They argue that falling trade barriers are allowing companies to move manufacturing jobs to countries where wage rates are low. Supporters, however, claim that free trade will prompt countries to specialise in what they can produce most efficiently, and to import everything else. They argue that the whole economy will be better off as a result. In other words, if you are in the USA and can buy an imported shirt that was made for cents in Honduras, you will have more money to spend on products the USA can produce efficiently like computers and software.

   The debate is now extended and continues over the impact of automation on global sourcing and job numbers, skills and related incomes. Will jobs be repatriated from global locations? Will those jobs be automated, leading to job loss wherever the work is located? (See Chapter 14 of this guide, and Willcocks, 2021b, Chapter 7.)

2. **Labour policies and the environment**: Critics fear that free trade encourages companies from advanced nations, where there are costly environmental standards, to move manufacturing facilities offshore to less developed countries with lax environmental and labour regulations. However, advocates of globalisation claim that environmental regulation and stricter labour standards go hand in hand with economic progress, so foreign direct investment actually encourages countries to raise their standards. Advocates of globalisation argue that by tying free trade agreements to the implementation of tougher environmental and labour laws, economic growth and globalisation can occur together with a decrease in environmental pollution.

3. **Shifts in economic power**: Critics of globalisation have worried that economic power was shifting away from national governments and towards supranational organisations like the WTO (see Chapter 6) and the European Union (EU) (see Chapter 5). However, globalisation's supporters argue that the power of these organisations is limited to that granted by their members. They also point out that the organisations are designed to promote the collective interests of members and they will not gain support for policies that do not achieve this goal. Since 2015, there was also some movement away

from international regulatory institutions, best exemplified by the USA's 'America First' policy from 2016–20 under President Trump. Some regional economic blocs have seen turbulence – for example the United Kingdom leaving the European Union at the end of 2020; the renegotiation of trade agreements between Mexico, USA and Canada; and China looking to gain more influence in economic blocs and trade arrangements in Asia Pacific.

4. **Wealth distribution**: Critics worry that the gap between rich and poor is growing and that the benefits of globalisation have not been shared equally. Supporters of globalisation concede the gap between rich and poor has got wider, but also contend that it has more to do with the policies countries have followed than with globalisation. For example, many countries have totalitarian regimes, or have failed to contain population growth, and many countries have huge debts that are hindering economic growth.

Willcocks (2021a) p.22, section 1.4, provides a useful listing of some major contributors and arguments in the globalisation debate and is worth looking at now. Consider also this question: if globalisation is such a good thing, why has there been a trend towards de-globalisation since at least 2015?

Activity

So where do you stand on the globalisation debate?

1. Make a list of the advantages that arise for your country, its citizens, and for multinationals.
2. Now make a list of how globalisation works against the interests of your country and its citizens, but also multinationals.

1.4.1 Does distance still matter?

Yet another debate exists over the degree of globalisation, its impacts and its implications for international business. Friedman (2005) believes globalisation is accelerating and is flattening the world so that every nation will eventually be part of the global marketplace and production process. Dicken (2007) calls this a 'hyper-globalist' view. Friedman takes a technological stance on globalisation, believing it to be shaped considerably by technological advances, cheap computer access and the easy assimilation and transportation of knowledge over the internet. Before computer access was a worldwide phenomenon, geographical distance had a big impact on how companies conducted business. Moreover, outsourcing would be harder as there would be no reliable, efficient way of collaborating with other departments, whether in the same office or in a different country.

Friedman argues that 10 'flatteners' have shaped globalisation and caused increased homogeneity in the world. By calling the world 'flat' he does not mean literally flat, of course. He means that geography, differences and distance increasingly cease to matter as a result of the influence of these 10 'flatteners'. These 'flatteners' include the fall of the Berlin Wall representing economic liberalisation; the development of internet protocols, workflow and open source software; the increased use of outsourcing and offshoring; the development of global supply chains; the increased use of specialised companies to carry out internal functions; the development of search engines and, latterly, of wireless, digital, mobile, personal and virtual technologies. From this perspective, technological capacity and connectedness define the parameters of globalisation and this is only set to continue as the age of the personal technology relationship is gaining momentum, where people not content with established information-sharing bodies take matters into their own hands with blogs, review sites and the establishing of their own media channels.

Although for 'hyper-globalists' like Friedman globalisation means free cooperation and connection with nations all over the world, to Ghemawat (2001; 2017) and Dicken (2007) flattening creates a general misconception about the extent of globalisation. In his influential article 'Distance still matters', Ghemawat (2001) argues that companies consistently 'overestimate the attractiveness of foreign markets'. He argues that the true amount of trade and investment between countries is influenced largely by geographical and cultural differences. He points out that countries 5,000 miles apart only carry out 20 per cent of the trade they would otherwise do if they were 1,000 miles apart. Furthermore, trade is 10 times more likely to take place if a country was a former colony of another, which, Ghemawat argues, significantly lowers the cultural barriers to trade. Arguing against Friedman's flattening thesis, Ghemawat elaborates that, while it has been claimed that global communications and technologies are 'shrinking the world, running it into a small and relatively homogenous place', this is not only an incorrect assumption but also a dangerous one.

The cultural difference between countries is still wide and complex, and although outsourcing and foreign direct investment have recently grown between nations, it is evident, as we shall see in Chapter 3, that cultural differences still prove challenging. In support of Ghemawat's argument, Dicken (2007) argues that quantitative and aggregative evidence suggests that the world economy was 'more open and more integrated in the half century prior to the First World War than it is today (2007)'. Ghemawat also supports this empirically based analysis, stating that cultural differences in religious beliefs, language, social norms and behaviours have a huge impact in the risk involved in trading and the likelihood of succeeding. His later evidence, in Ghemawat (2017), reaffirms this. Therefore, according to these theorists, globalisation cannot be said to be flattening the world.

Dicken explains that part of the problem with defining globalisation is understanding that aggregative and quantitative analysis, though valid, are not the only story we should take on board when looking at the world economy today. The economy in the 21st century, he goes on to suggest, constitutes a deep and complex integration that cannot be captured in the statistics of trade and foreign direct investment. Instead, globalisation is 'a supercomplex series of multi-centric, multi-scalar, multi-temporal, multi-form and multi-causal processes'. This explanation, in contrast to Friedman's linear model of technological progress, is more dynamic and circulatory in design.

In 'Distance still matters' and his 2017 work, Ghemawat complements this view by suggesting that companies often overestimate the ease with which their business can move abroad. The cultural, administrative and geographical distance between nations presents a fundamental challenge to companies facing the globalisation of the world economy today. As just one example, Coca-Cola had problems in the Peruvian market when they attempted to replace Inca Kola, the national beverage, with their own US-branded cola. The Peruvian people held mass demonstrations against Coca-Cola until their Inca Kola was returned to the shelves. Being sensitive to national differences is not just a consideration; in international business it may well be an imperative to survival – something we explore in detail in Chapters 2, 3 and 7.

Ghemawat (2017) confirms his earlier analysis and posits two laws, strengthened by the 2020–21 crisis, and worth noting in any globalisation debate:

- **The law of semi-globalisation**: international interactions, while non-negligible, are significantly less intense than domestic interactions.
- **The law of distance**: international interactions are dampened by distance in terms of culture, administration, geography, and are often affected by economic distance as well, a law that also holds in cyberspace.

Activity

Read Ghemawat (2001) 'Distance still matters', and Willcocks (2021a), Chapter 1, pp.23–25, section 1.5.

1. How 'flat' do you think the world is? Who is right?
2. If, in 2021, a UK multinational retailer of men and women's clothing chose to operate in your country, what difficulties do you think they would encounter? Recall also that the UK left the European Union in December 2020.

1.5 What does globalisation mean for companies?

All this means that managing an international business, or any company that engages in international trade or investment, will be very different from managing a domestic business. In particular, companies operating internationally will find that countries and cultures differ – a subject we will explore in much more detail in Chapters 2 and 3. It will emerge from those chapters that the range of problems faced by managers is greater and more complex, not least because government intervention in markets creates limitations for companies, as do the ways in which the global trading system operates and the existence of international institutions as we shall discover in Chapters 4, 5 and 6. At the same time, companies can work with the forces for globalisation and improve their global performance. Such forces include:

- **Low barriers to trade and investment**: These mean that companies can see the world, rather than a single country, as their market. Low trade and investment barriers also mean that companies can locate production facilities in the optimal location, wherever in the world that might be. Production and sales now take place in multiple markets, creating interdependency between countries for goods and services.
- **Technological change**: Major advances in communication, information processing and transportation technology have made what had been possibilities into tangible realities. The cost of global communication has fallen, for example, because advances in telecommunications and information processing help companies to coordinate and control global organisations at a fraction of what these costs might have been even a decade ago. The microprocessor that facilitates high-power, low-cost computing is perhaps the most important of these developments. Dell, for example, takes advantage of these innovations to control its globally dispersed production system. When a customer submits an order via the company's website, it is immediately transmitted to the suppliers of the various

components, wherever they are located in the world. Suppliers have real-time access to Dell's order flows and can then adjust their production accordingly. Dell uses inexpensive air freight to transport its products to meet demand as needed. The company maintains a customer service operation in India where English-speaking personnel handle calls from the USA. Indeed, the internet has made it possible for even small companies to play a role in the global economy. Yet, less than 20 years ago, this technology did not even exist. Internet usage was less than 1 million users in 1990 to 4.39 billion in 2019. Just looking at the internet, global e-commerce sales surpassed $US two trillion for the first time in 2017, and have been on a rising trend since. The internet is a global equaliser, lessening the constraints of sale, location and, obviously, time zones. Meanwhile, the microprocessor that facilitates high-power, low-cost computing is perhaps the most important of these developments.

- **Transportation improvements**: Improvements in transportation such as containerisation and the development of super freighters have also facilitated the growth of globalisation. Even in 2021, 90 per cent of the world's traded goods were shipped by sea. The time it takes people and products to get from one place to another has shrunk, as has the cost. For example, Ecuador has been able to capitalise on falling transportation costs to become a global supplier of roses. As an experiment, surprise yourself and analyse where the goods you buy and use on a daily basis come from.

While there have been huge global shifts in how firms do business, there is evidence that the strongest companies are not only international but also strategically sensitive to localising their products or service when operating in different markets (we shall see more about this in Chapter 7). For example, Google found this to be a winning combination in their expansion into China. Here, despite an initial backlash, Google pursued a local strategy for their Chinese market using a Chinese name for their search engine and customising their web page to fit the tastes of Chinese internet users, who tend to spend longer on a given page and read the left-hand side of the screen first. However, global linkages and interdependencies and working in foreign markets also mean global risks. As a symbol of the risks of globalisation for a company, Google also ran into subsequent problems with the Chinese government on a number of issues.

1.6 Key concepts

The key concepts in this chapter are:

- globalisation and deglobalisation
- multinational enterprises (MNEs)
- foreign direct investment (FDI)
- World Trade Organisation (WTO)
- International Monetary Fund (IMF)
- United Nations (UN)
- developed and emerging economies
- 'the world is flat'
- globalisation trends
- globalisation debates
- distance still matters.

1.7 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define the major characteristics of globalisation
- assess the global economy and its broad trends
- explain the major trends in globalisation, and the major players in the globalisation process
- enter into the major globalisation debates and assess under what conditions and for whom globalisation can be considered an advantage or disadvantage
- describe the implications of globalisation for companies operating internationally
- assess the short- and long-term impacts on international businesses arising from the COVID-19 and economic crises, and emerging global trends, including de-globalisation.

1.8 Test your knowledge and understanding

1. Read the case study 'GE healthcare in India – locally driven innovation' (VLE Chapter 1).
   a. What are the similarities and differences between traditional and reverse innovation?
   b. Why is GE so interested in reverse innovation?
   c. What are the main concerns that prevent western MNEs from aggressively investing in emerging economies? What are the costs of not doing so?
   d. Why is a leading US multinational like GE afraid of emerging multinationals from emerging economies?
2. View the video (six minutes) on deglobalisation: www.youtube.com/watch?v=OQSogUd_5go

   Answer the following questions, taking notes:
   a. What is deglobalisation and what is the evidence for it?
   b. Why are global brands becoming distrusted?
   c. The localisation in India is worth noting. What is happening here, and why?

1.9 Sample examination question

'The phenomenon of globalisation has given rise to major benefits and costs for countries and companies in the contemporary world economy.' Discuss this statement by considering the following questions:

a. What are the major trends underlying globalisation?

b. What do supporters of globalisation see as its major benefits for countries and international firms? What do critics see as the major drawbacks and disadvantages with globalisation for international firms and countries?

c. In recent years, we have seen a slowing down of globalisation. Why is this, how has the pandemic and economic crises of 2020–21 contributed, and what are the most recent trends impacting on international businesses?

Chapter 2: Political, economic and legal environments

2.1 Introduction

You already know that the political, economic and legal systems of countries differ. But you may not know what these differences are, and how and why they are important to companies that do business in foreign markets. In practice, managers working abroad should have a thorough understanding of a country's formal institutions before entering that country. In this chapter, we are going to explore these institutions and related systems, known collectively as the political economy of a country, and what they mean for businesses operating internationally. In doing so, we will introduce something called 'an institution-based perspective'. As we shall see, political, economic and legal institutions establish the formal 'rules of the game' for operating in a particular country. The key functions of these institutions are to reduce uncertainty, reduce transaction costs and constrain opportunism. We will look at the equally and sometimes more important informal rules in Chapter 3.

In this chapter we will look at the varieties of political systems, ranging from totalitarianism through to different types of democracy. We will also examine systemic differences among economies, ranging from pure market economies and liberal market economies through to coordinated market economies. We will also explore the basic differences between legal systems. Finally, we will consider how these political, economic and legal institutions influence the economic development of a country and their implications for international business managers.

2.1.1 Aims of the chapter

The aims of this chapter are to:

- identify the nature of formal institutions in different countries, and the ways in which these reduce uncertainty
- introduce the major types of political, economic and legal systems, and point out the similarities and differences in these across countries
- develop knowledge of how these attributes and differences across countries impact and constrain how businesses operate internationally
- provide a platform for debating the role of national formal institutions in international business and how they can be managed.

2.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define the concept of institutions and delineate their key role in reducing uncertainty
- explain the basic differences between political systems and their influence on international business
- discuss the systemic differences among economies and the related challenges for international business
- describe the basic differences between legal systems in the world
- engage in and assess leading debates on political, economic and legal institutions and international business.

2.1.3 Essential reading

Peng, M., D. Wang and Y. Jiang 'An institution-based view of international business strategy', *Journal of International Business* 39 2008, pp.920–36.

Willcocks, L. *Global business: strategy in context*. (Stratford-upon-Avon, UK: SB Publishing, 2021a) Chapter 2.

2.1.4 Further reading

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapter 2.

2.1.5 References cited

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Hall, P. and D. Soskice (eds) *Varieties of capitalism.* (Oxford: Oxford University Press, 2001).

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2.1.6 Synopsis of chapter content

The institution-based view of international business; overview of political, economic and legal systems; how political economic and legal trends develop in different countries.

2.2 An institution-based view of international business

Peng and Meyer (2019) are great proponents of the institution-based view of international business. You can read more about this in Peng, Wang and Jiang (2008). They argue that, essentially, a country's institutions establish the formal and informal rules for operating in that country. Companies operating internationally need to know these rules, because they differ between countries and because they shape what can be achieved and what is not possible in a country. Institutions can be formal or informal.

Formal institutions consist of laws, regulations and rules. Informal institutions consist of norms, cultures and ethics. In this chapter we focus on the formal institutional framework – laws, regulations and rules – of a country that governs the behaviour of individuals and companies.

What do institutions do? Essentially their key role is to reduce uncertainty by limiting the range of acceptable actions. Institutions have developed over time because the potential adverse consequences of uncertainty can be devastating. For example, if you were trying to do business in the Middle East in 2021 – say in Egypt; United Arab Emirates; Israel; Qatar; or Lebanon – imagine the immense difficulties of just understanding the business **context**, let alone deciding what to do. Uncertainty increases transaction costs, a term made highly popular by Oliver Williamson (1985). Transaction costs are the costs associated with carrying out an economic transaction or, in short, the costs of doing business – for example, search, negotiation, getting to contract and monitoring supplier performance. Transaction costs will increase if others behave opportunistically, defined by Williamson as 'self-interest seeking with guile'. Institutional frameworks can reduce the potential for such opportunistic behaviour. This is important for international business, because if transaction costs become prohibitively high in a country, people may choose not to undertake trade in that country at all.

Institutions are evolving all the time, and international business managers need to keep up with these changes. For example, in the last decade and more, China, Poland, Russia and Vietnam have been moving from central planning to market competition, though each in different ways, and at different speeds, and in the case of China and Russia more recently there have been some re-centralising tendencies. These are often called transition economies. Institutional transition can be defined as fundamental and comprehensive changes to the formal and informal rules of the game that affect organisations as players.

In summary, Peng and Meyer (2019) argue, convincingly, that, for international businesses, institutions matter. They suggest that at the heart of an institution-based view there are two core propositions. Firstly, managers and firms rationally pursue their interests and make choices within the formal and informal constraints of a given institutional framework. Secondly, although formal and informal institutions combine to govern firm behaviour, in situations where formal constraints fail or are unclear, informal constraints will play a larger role in reducing uncertainty and providing constancy to managers and firms. We will focus on the role of informal institutions in Chapter 3.

Activity

Read the Wikipedia entry on South Africa, focusing particularly on the sections on political, legal and economic characteristics – sections 4 and 5:

- https://en.wikipedia.org/wiki/South_Africa

1. Imagine you run a manufacturing company from your own country. What do you see as the main institutional – political, economic and legal – challenges of doing business in South Africa?
2. What are the sources of transaction costs in doing business with South Africa?
3. How important do you think informal institutions are in doing business in South Africa?

2.3 Political systems

A political system represents the 'rules of the game' on how a country is governed politically. You can think of political systems as having two dimensions: first, the degree to which they emphasise collectivism as opposed to individualism, and second, the degree to which they are totalitarian or democratic.

2.3.1 Collectivism versus individualism

Collectivism refers to a system that stresses the primacy of collective over individual goals. In other words, in a collectivistic society the needs of the society as a whole are generally viewed as being more important than individual freedoms. In modern times collectivism has been equated with socialism and state ownership of the basic means of production, distribution and exchange. During the late 1970s, communism, with strong command economies, was a dominant force in the world. You might think of the former Soviet Union, for example, and its eastern European neighbours like Poland, Czechoslovakia and Hungary. Think also of China, Cambodia, Vietnam, Angola, Mozambique, Cuba and Nicaragua. By 2000, the world was a very different place than it had been in the 1970s. The Soviet Union, for example, had been replaced by 15 republics that were structured as democracies. China, though it still limited political freedom, was moving away from its strict communist ideology. Today, only a few fringe states like Cuba and North Korea still practise a strong brand of communism. Social democracy, which believes in a mixed economy of central planning, state and private enterprise, has also been fluctuating. For example, countries like the United Kingdom and France have placed less emphasis on state ownership of the means of production and have seen moves towards privatisation (i.e. selling state-owned enterprises to the private sector).

Individualism has been championed by economists such as Adam Smith, Milton Friedman and Friedrich von Hayek. It is based on two key concepts: first, that individual freedom and self-expression are guaranteed and, secondly, that people are allowed to pursue their own self-interest within the rule of law and that this will achieve the best overall good for society. For international companies there is a debate about how important individualism and the related idea of free market economics are for creating a favourable business environment, and about who gains from applying these concepts in international trading environments.

2.3.2 Totalitarianism

You can think of totalitarianism and democracy as being at opposite ends of a political dimension. At one end, totalitarianism means one person or political party exercises absolute control over all spheres of life, and opposing political parties are forbidden; and at the other end democracy is a system in which government is by the people, exercised either directly or through elected individuals. While we generally think of democracy as going hand-in-hand with individualism, and totalitarianism as being associated with collectivism, grey areas do exist.

For example, China is still under totalitarian rule, but has adopted free market policies that tend to be associated with individualism (though in recent years commentators have pointed to a return to greater communist party control). In recent years Russia has become increasingly totalitarian, while still holding to some democratic forms (e.g. elections). The world has seen four major forms of totalitarianism:

- **Communist totalitarianism** advocates achieving socialism through totalitarian dictatorship. While this form of totalitarianism is declining worldwide, countries like Vietnam, Cuba and North Korea still follow the philosophy.
- **Theocratic totalitarianism** is where political power is monopolised by a party, group or individual that governs according to religious principles. This type of system exists in countries such as Saudi Arabia and Iran. Both countries are greatly influenced by the principles of Islam, and both countries restrict political and religious freedom.
- **Tribal totalitarianism** is where a political party that represents the interests of a particular tribe monopolises power. This type of system has occurred, for example, in some African nations like Zimbabwe, Uganda and Tanzania.
- **Right-wing totalitarianism** may allow individual economic freedom, but individual political freedom is restricted to avoid forms of socialism. A nation's military often backs this type of system. This type of system has been declining, but existed in Germany and Italy during the 1930s and 1940s. Military dictatorships were frequent in Latin America, such as Brazil (1964–1985) and Chile under General Pinochet. They could also be found at various times in Asian countries like Taiwan, Indonesia, Philippines and South Korea, though these have since become more democratic.

2.3.3 Democracy

A pure democracy is based on the belief that people should be directly involved in decision making. The most common form of democracy today, however, is representative democracy, where elected representatives vote on behalf of constituents.

Reputed characteristics of democracies include freedom of expression, free media, regular elections, a fair justice system and free access to state information. The political system is governed by institutions.

The rules are usually laid down in a constitution, determining things such as how elections are organised, how votes are translated into representation in a parliament and how much power the elected officials and representatives have. There are notable variations in representation methods, including:

- **Proportional representation versus first-past-the-post**: Countries such as Germany and Denmark have systems whereby all votes are added up and seats are allocated to political parties in proportion to the number of votes they gained. Countries like India, the USA and the UK have a first-past-the-post system where each constituency elects one representative based on who has won the most votes in the election.
- **Direct versus indirect elections of government**: Some countries have direct elections for certain posts (e.g. citizens of France and the USA directly elect their presidents with executive power to appoint ministers). In most countries citizens elect representatives who then, on the citizens' behalf, elect and monitor government and ministers.
- **Representative versus direct democracy**: In most countries citizens elect representatives to act on their behalf.
- **Centralisation of power**: There are variations between countries in the degree of power held by central, regional and local governments. For example, in federated countries like Australia and the USA, states wield quite a lot of power. In the UK, central government has devolved quite a lot of functions to the Scottish, Welsh and Northern Irish assemblies.

Political systems matter for international business because they:

- set the rules and whose interests are served by the rules
- determine whether and how businesses can influence legislative processes through lobbying (mostly legal) or corruption (usually illegal)
- influence how frequently, and in what ways, the rules of the game for business change, which can be a major source of political risk since political changes may negatively affect domestic and foreign businesses.

Activity

Read Willcocks (2021a), pp.43–46 section 2.3, noting the diagram on p.46.

1. How do elections and political processes work in your country?
2. How do elections and political processes work in a country with which your country trades a great deal?

2.4 Economic systems

An economic system refers to the rules by which a country is governed economically. Broadly, there are three types of economic system:

- **Market economy**: Here goods and services are privately owned and production quantities are determined by supply and demand. In a market economy, governments encourage free and fair competition and discourage monopolies. Note that there have been very few pure market economies. In 2001, Hong Kong had the highest degree of economic freedom, but there was still some noticeable government intervention in the economy. By 2021, Honk Kong's economic (and political and legal) freedoms had been seriously curtailed. More generally, the 2008–09 financial crisis and its aftermath, then the 2020–21 pandemic crisis saw increased government intervention in many countries across the world. How permanent did these interventions need to be?
- **Command economy**: Here the goods and services that a country produces, the quantity in which they are produced and the price at which they are sold, are planned by the government. Businesses are state owned and the government allocates resources for the good of society as a whole. An example of a command economy was the former Soviet Union and, in 2021, North Korea.
- **Mixed economy**: Here elements of both a market economy and a command economy are present. Governments often take control of industries that are considered vital to national interest. Examples include France, the UK and Sweden in the 1980s, though subsequently all three counties have reduced state ownership and undertaken more privatisation. India, Brazil and Italy have also sought, over the years, to reduce their large state-owned sectors, though they still retained a number of such state-owned enterprises into 2021.

In 2021 most countries were more or less market economies – they organise themselves by market forces but also have varying degrees of non-market coordination. The 'varieties of capitalism' view embodies this reality. Hall and Soskice (2001) suggest that, due to history, culture, resources and other factors, countries can vary enormously in how they combine market and non-market mechanisms to coordinate economic activity. Moreover, these economies will be constantly changing in the modern dynamic global environment. The view suggests two main types of economy (Willcocks, 2021a):

- **Coordinated market**: This operates through a system of coordinating by market signals together with a variety of other means, as, for example, in Italy, the Netherlands and Japan. Such economies may well have more employment protection and less ability to raise capital through the stock market. In Germany, for example, employees have representatives on corporate boards (unlike in the UK) and government is much more directly involved in vocational training. In Asia, many countries have embraced liberal market principles but also have a strong state providing direction and investment supporting the economic development path (e.g. South Korea, Singapore).
- **Liberal market**: This operates through a system of coordination primarily through market signals. Hall and Soskice (2001) suggest the UK, the USA, Canada and Australia were examples of this in 2000, though it is important not to understate the extent of government involvement in economic development even in these states, especially during periods of economic crisis.

Activity

Read Willcocks (2021a) Chapter 1, pp.47–48, section 2.4.

1. Describe your own country's economy. Is it a market, command or mixed economy?
2. What is the degree of coordination and liberalisation in your economy?
3. Has your country changed in terms of type of economy in the last 10 years? How?
4. Do you foresee further changes in the next five years, following the pandemic and economic crisis of 2020–21?

2.5 Legal systems

A legal system represents the formal rules that regulate behaviour, along with the processes by which the laws of a country are enforced and through which redress for grievances is obtained. The importance for international managers is that a country's laws regulate business practice, define the manner in which business transactions are to be executed and set down the rights and obligations of those involved in business transactions. The legal system impacts on the attractiveness of a country as a business investment or a potential target market (see Chapters 4 and 6 below). A country's legal system is influenced by its political system. So, countries that are 'collectivistic totalitarian' states tend to restrict private enterprise, while 'individualistic market' economies support private enterprise and consumer rights.

There are three broad types of legal system. Note, however, that it is common for legal systems to be influenced by multiple legal traditions:

- **Common law** is based on tradition, precedent and custom. Judges look at how previous cases have been treated to decide how to treat current cases. Then, as new precedents are made, laws can be amended if necessary. Common law is English in origin but has stretched to many English-influenced countries (in Africa, Asia, South Africa, and also Canada and the USA). It is based on statutes, customs and court decisions. Judges are arbiters and juries are decision makers. The implications for business are greater freedom to design contracts and codes of practice; detailed contracts are needed to fill in for gaps in the legal framework; more legal disputes involving much use of lawyers; a greater legal burden may favour the more powerful companies.
- **Civil law** is based on a detailed set of laws organised into codes. This type of system, which is practised in more than 80 countries including Germany, Japan and Russia, is less adversarial than common law because under civil law, judges only have the power to apply the existing law, not interpret the law. Here law is codified in books of law, and judges lead the proceedings including questioning and deciding. For businesses the implications tend to be relatively short contracts and codes of practice, and more consumer and employee protection available under the law. Businesses often complain about the bureaucracy of civil law, but civil law also often gives greater legal certainty (e.g. in France and Germany).
- **Religious, or theocratic law** is based on religious teachings. Today, Islamic law is the most widely practised theocratic law system in the world and is practiced in countries including Iran, Libya, Saudi Arabia and Morocco. In practice, Islamic jurors and scholars are struggling to apply the foundations of Islamic law to the modern world, and many Muslim countries today are actually practising Islamic law combined with common law or civil law.

Why it is important for international companies to be familiar with the legal system in the countries in which they operate? One key reason is because each system approaches the enforcement of contracts in a different way. So, suppose you come from a common law state, and you have signed an agreement with a company operating under a civil law system. Which law should apply? To deal with this type of scenario, about 83 countries as of 2016 had signed the United Nations Convention on Contracts for the International Sale of Goods (CIGS), which established a uniform set of rules governing certain aspects of the making and performance of everyday contracts between sellers and buyers who have their places of business in different nations.

2.5.1 Issues for international businesses

Legal systems are also important for dealing with several other essential issues for international businesses:

- **Property rights**: Property rights are the legal rights over the use to which a resource is put and over the use of any income that may be derived from that resource. In some countries, even though there are laws protecting property, the laws are not consistently enforced. Property rights can be violated through private actions and through public actions. Private violations like theft, piracy or blackmail are done by individuals. Keep in mind that this type of violation can take place in any country, but in countries with weak legal systems, like Russia, it is a much bigger problem. When public officials like politicians and bureaucrats violate property rights, they might use legal mechanisms such as levying excessive taxes, as in Venezuela in the 2000s, or requiring special expensive licences, or even simply taking assets into state control.
- **Intellectual property issues**: Intellectual property rights are rights associated with the ownership of intellectual property – which can include anything from computer software or a chemical formula for a new drug to a screenplay or a music score. Intellectual property can be protected in three ways:
    - A **patent** gives the inventor of a new product or process exclusive rights to manufacture, use or sell the invention.
    - A **copyright** is the exclusive right of authors, composers, playwrights, artists and publishers to publish and dispose of their work as they see fit.
    - A **trademark** is a design or name that may be officially registered, that allow merchants or manufacturers to designate or differentiate their products.

Protection of intellectual property rights varies by country. China and Thailand are currently among the world's biggest violators of intellectual property rights. In Latin America, about 68 per cent of all software is pirated, and in China some studies estimate that 86 per cent of software is pirated. Nearly 200 countries have signed the Paris Convention for the Protection of Industrial Property to protect intellectual property rights, and are part of the World Property Organisation, but enforcement of property regulations is still lax in many countries. What can you do if your intellectual property is stolen? You can lobby your government to take action. You can also file your own lawsuit. For example, Starbucks was successful in suing a Chinese company that opened stores that were almost replicas of the traditional Starbucks store.

- **Product safety and product liability**: Product safety laws set certain standards to which a product must adhere and product liability involves holding a company and its officers responsible when a product causes injury, death or damage. These vary greatly across countries. This often leads to an ethical dilemma for companies. What should a company do if the standards in a foreign market are lower than the standards at home? Should they comply with home standards even if this puts them at a competitive disadvantage?
- **Corporate governance**: This involves the rules by which shareholders and other interested parties control corporate decision makers. Variations across countries are closely related to differences in economic and legal systems. Generally, common law systems have evolved in ways that provide strong protection for financial investors (i.e. shareholders). In civil law countries, for example Germany and Denmark, the law tends to offer less protection for shareholders and more rights to other stakeholders in the company – for example, non-managerial employees who tend to be represented on corporate supervisory boards.

Activity

Read the case study 'Who is breaking whose copyright?' (VLE Chapter 2). Ask yourself:

1. In your view, were the British behaving legally?
2. Why do you think legal systems and international agreements have such a poor record against copyright and IP violations?
3. How could the IP laws in your own country be strengthened?

2.6 Country development: political, economic and legal issues

The political, economic and legal environments of a country can have a significant impact on its economic development, and on its attractiveness as a potential investment location or target market. Economic development levels can be measured using gross national income per person, or GNI. But GNI measures can be misleading because they do not take into account cost of living differences. So, we adjust these numbers by purchasing power. Using purchasing power parity (PPP), we can adjust the numbers to reflect how far your money actually goes in a particular country. What does this mean for companies? Well, looking at a PPP-adjusted GNI for India in 2007, we would conclude that the average Indian could only consume about 6 per cent of the goods and services consumed by the average US citizen. Should US businesses have discounted India as a potential market then? No, because if we look a little deeper we would find that the country has an emerging middle class of about 100 million people that represents a tremendous opportunity for foreign companies.

Are there other ways to measure economic development? Sen (1999) argues that, rather than simply focusing on material output measures like GNI per capita, we should consider the capabilities and opportunities people enjoy when measuring economic development. Sen believes that economic progress includes things like removing impediments to freedom, such as tyranny, poverty and the neglect of public facilities, and a democratisation of political communities so that citizens have a voice in decision making. So, for example, Sen argues that providing basic healthcare and education is essential for economic growth. The UN has incorporated Sen's ideas in its Human Development Index, or HDI, which measures the quality of life in different countries. HDI is based on life expectancy at birth, educational attainment and whether average incomes in a country are sufficient to meet the basic needs of life in that country.

Why do some countries succeed in economic development while others fail? Some argue that investment and technological progress explain capital accumulation, higher productivity and thus increasing economic success. Many policy makers and scholars argue that innovation and entrepreneurship are the engines of long-run economic growth, and that innovation and entrepreneurship require some form of market economy. In other words, new products and business processes can increase the productivity of labour and capital. Similarly, innovation and entrepreneurship probably require strong property rights. If the innovations by, say, Microsoft or Samsung were not given protection, there would have been little incentive for the companies to continue to develop new software and technological products.

Others argue that human capital is the key to prosperity; so developing counties must invest in higher education. Others relate success to market-friendly, macro-economic policies by government, including low inflation, stable exchange rates, low trade barriers and low government budget deficits. Peng and Meyer (2019) line up with the argument of North (2005) and see political, economic and legal institutions as the basic determinants of a country's national economic performance because these influence incentives and the costs of doing business:

- Institutions ensure that companies are able to make gains from trade.
- Lack of strong, formal market-supporting institutions force companies to trade on a much more informal basis, incurring political, legal and economic risks in conditions of instability and over-dependence on informal relationships.
- Emerging formal market-supporting institutions support foreign businesses moving into complicated long-distance trade with a country because they can see reasons for specialisation and growing in size, and making long-term commitments to international trade there.
- If property rights are protected, this will fuel innovation, entrepreneurship, more economic growth and increased inward investment.

Activity

Read Willcocks (2021a) Chapter 2, Section 2.6, pp.32–33,

1. Why are formal institutions important for developing countries?
2. Read the case study 'Economic transformation in Vietnam' (VLE Chapter 2).
    a. What changes in formal institutions and economic policy explain Vietnam's progress in recent years?
    b. How should the government and international businesses deal with the high levels of corruption?
    c. If you were going to enter Vietnam as a new market, what formal institutional risks would you anticipate?
    d. How would you mitigate those risks?

2.7 Key concepts

The key concepts in this chapter are:

- institution-based view
- collectivism versus individualism
- market, command and mixed economies
- coordinated market
- liberal market
- types of totalitarianism
- proportional representation
- representative democracy
- civil law, common law and religious law
- property and intellectual property rights.

2.8 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define the concept of institutions and delineate their key role in reducing uncertainty
- explain the basic differences among political systems and their influence on international business
- discuss the systemic differences among economies and the related challenges for international business
- describe the basic differences between legal systems in the world
- engage in and assess leading debates on political, economic and legal institutions and international business.

2.9 Test your knowledge and understanding

1. How do you think a country might make the shift from a centrally planned to a more market-based economy?
2. You are looking to sell goods to another country (pick one you know something about). What are the costs of doing business in this foreign market? Given the costs of doing business in a foreign market, is it worth it?
3. What do you think are the factors that explain the degree of development and success experienced by your own country over the last 10 years? What were the roles of political, economic and legal institutions?

2.10 Sample examination question

'Formal institutions greatly affect and shape the strategies that are possible in specific countries and markets.'

Therefore:

a. Describe, using examples, the major political institutions an international business needs to take into account in designing its strategy.

b. Describe, using examples, the major economic institutions an international business needs to take into account in designing its strategy.

c. Describe, using examples, the major legal institutions that will impact on a business operating globally

d. Why are formal institutions important for:

   i. developing economies?

   ii. international trade?

   iii. multinationals?

Chapter 3: Informal institutions: cultural, social and ethical challenges

3.1 Introduction

If you ever visit a foreign country, you will probably notice some differences in how people dress, the food they eat or their choice of transportation. Perhaps a particular religion influences how society works, or a different language is spoken. All of these things are manifestations of culture. Just as you would adapt for differences when away from home, when doing business in foreign countries, companies need to adapt as well.

In this chapter we look at the informal institutions that companies need to take into account when operating internationally. In particular, we will focus on the differences between countries in culture, religion, language, ethics and approaches to corporate social responsibility. Culture is a system of values and norms that are shared among a group of people and that, when taken together, constitute a design for living. Values are abstract ideas about what a group believes is good, right and desirable, and norms are the social rules and guidelines that prescribe appropriate behaviour in particular situations. Long-standing cultural differences still influence how business is being done. Also, keep in mind that culture is dynamic, in other words it is always changing.

We will discover in this chapter that managers and companies unfamiliar with foreign languages and religious traditions may end up making mistakes that harm their business. We also explore different approaches to ethics in international business, and how variations on ethics across countries can create ethical dilemmas, as can a range of differences about dealing with such issues as the environment, labour, human rights and corruption. We also explore companies' different corporate social responsibility (CSR) strategies, and whether CSR is vital to or a diversion from what international businesses need to be focusing on.

3.1.1 Aims of the chapter

The aims of this chapter are to:

- explain the concept of culture and provide means by which different cultures can be analysed and described
- identify the different type of language and religion across the globe, and their relevance to understanding cultures and behaviours
- pinpoint the importance of ethics in international business, and how what is considered ethical varies across countries, and religions
- introduce possible managerial responses to informal (and formal) institutions, with particular reference to corporate social responsibility activities
- examine possible strategies for corporate sustainability practices
- analyse corruption in the international business environment and assess corruption reduction strategies.

3.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define what culture is and articulate two of its manifestations, namely language and religion
- discuss how cultures systematically differ from each other
- explain how language competences shape intercultural interactions
- explain how religions shape cultures
- describe the importance of ethics
- summarise corporate social responsibility challenges faced by companies operating in the global economy
- discuss how institutions influence companies' corporate social responsibility activities and sustainability practices
- describe forms of corruption in international contexts, and suggest counter-policies
- participate in leading debates about culture, social responsibility and sustainability
- draw implications for management action.

3.1.3 Essential reading

Willcocks, L. *Global business: strategy in context.* (Stratford-upon-Avon, UK: SB Publishing, 2021a) Chapter 2.

3.1.4 Further reading

Hill, C. *International business: competing in the global marketplace*. (New York: McGraw Hill, 2021) 13th edition Chapters 4 and 5.

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3.1.6 Synopsis of chapter content

Culture – definitions and role in international business; language differences and impacts; religion and ethics on the world stage; corruption and its mitigation ; corporate social responsibility (CSR) and corporate sustainability practices in international business.

3.2 Cultures and international business

Informal institutions come from socially transmitted information and are part of the heritage that we call culture. They tell individuals in a society what behaviours are considered right and proper, and what would be unacceptable. Typically, cultures have no clearly defined origin, but have evolved over time. Those within a society tend to perceive their own culture as 'natural, rational and morally right'. This self-centred mentality is known as ethnocentrism. Culture can be seen as the collective programming of the mind that develops over time, which distinguishes the members of one group or category of people from another. Though we talk about French culture and Japanese culture, culture is not necessarily divided by national boundaries. Some countries like Switzerland have multiple distinct cultures, in this case German, Italian and French. Similarly, some cultures transcend national boundaries. For example, you might think of how the values promoted by Islam influence many countries.

Culture has been described as 'the way things are done round here' and also as the shared norms, values and assumptions of a group, organisation or society that translate into distinctive behaviours. The social rules that govern people's actions towards one another are called norms, which you can think of as the routine conventions of everyday life like dress codes, social manners and accepted codes of conduct.

What determines culture? The values and norms of a culture evolve over time and are a function of a number of factors at work in a society including religion, political and economic philosophies, education, language and social structure. How can we understand differences in culture? Willcocks (2021a) distinguishes between three approaches – the context approach, the cluster approach and the dimensions approach.

3.2.1 The context approach

Context is the underlying background upon which interaction takes place. In low-context cultures (such as in North American and western European countries), communication is usually taken at face value without much reliance on unspoken context. In other words, yes means yes. In contrast, in high-context cultures (such as Arab and Asian countries), communication relies a lot on the underlying, unspoken context, which is as important as the words used. For example, 'yes' does not necessarily mean 'yes, I agree', it might mean 'yes, I hear you'. Failure to understand context and differences in interaction style can lead to misunderstandings in international business. According to this theory, Chinese, Korean, Japanese and Arab cultures are high context, while German, Canadian and Swiss, for example, are low context. This looks a bit simplistic, however. Critics point out that the context approach may exaggerate the lack of context in so-called 'low context' approaches, and that all cultures, national, business or otherwise, as products of history and tradition, have important unspoken aspects, which are as important as the words used. Also the context approach only looks at one dimension, unlike the dimensions approach detailed below.

3.2.2 The cluster approach

A cluster in this case is a group of countries that share similar cultures. There are three main theories of clusters. Ronen and Shenkar (1985) identify eight clusters, while the Globe Global Leadership and Organisational Behaviour Effectiveness – study (House et al., 2004) proposes 10, of which five are similar to the Ronen and Shenkar study. Huntingdon (1996) proposed eight 'civilisations'. The clusters are a useful way of looking at things, because we need to understand that in international business people will feel more comfortable doing business with countries and businesses from the same cluster. However, the approach tells us little about differences between countries within a cluster (e.g. between Argentina and Brazil).

3.2.3 The dimensions approach

The most extensive studies exploring this have been done by Hofstede (1997). He and his colleagues initially identified five dimensions of culture: power distance, individualism versus collectivism, masculinity versus femininity, uncertainty avoidance and long-term orientation. These are well described in Willcocks (2021a) Chapter 3, p.78, section 3.2. Subsequently Hofstede and Minkov (2010) identified a sixth dimension – indulgence – referring to the freedom social norms give to the individual to fulfil his/her human desires.

Note that Hofstede's studies record only **relative** culture differences between countries. Hofstede's work has been criticised. While Hofstede's original study gave us many important insights into cultural differences, his study was flawed in that he made the assumption that there is a one-to-one relationship between culture and the nation-state. In addition, the research was culturally bound since it was conducted only by Europeans and North Americans, and the study may have been biased since it took place within a single company, IBM. It is important for you to read about and note the strengths and limitations of Hofstede's work. Hofstede provides a good starting point for a cultural analysis that needs to be more fine-grained if it is to influence actual management practice.

You need to note a further 'dimensions' approach put forward by Trompenaars (1993). Building on Hofstede's work, he suggests seven dimensions of culture in the workplace. These are described in Willcocks (2021a) Chapter 3, pp.79–80 section 3.2.

What are the implications of all of this for managers? It is vital for international businesses to develop cross-cultural literacy. To be successful, you have to be able to conform and adapt to the value system and norms of the host country. One way you can gain knowledge of the local culture is to hire local citizens. Developing a cadre of cosmopolitan managers who have been exposed to different cultures can also be helpful. It is important to avoid being ethnocentric, believing that your ethnic group or culture is superior to that of others.

A second reason for companies to be aware of cultural differences is the link between culture and competitive advantage. The value systems and norms of a country influence the costs of doing business, which of course then affect the competitive advantage of the company. A society's class structure affects the relationship between management and labour, for example – look at Japan's strong worker loyalty system, where lifetime employment guarantees affect the success of Japanese companies. Similarly, it has been suggested that a more individualistic culture promotes entrepreneurial activities as compared to a culture that emphasises collective behaviour. These differences provide companies with insight as to which countries are most likely to produce competitors, and which countries will be the best for investing or selling (see also Chapter 12 below on the subject of location attractiveness).

A third reason is that cultural sensitivity leads to better cross-cultural management of diverse workforces. Collinson, Narula and Rugman (2017) summarise a number of research studies and suggest that cultural diversity can be managed by:

- **Recognising diversity**.
- **Building diversity issues** into such areas as recruitment; HRM planning; strategy; location decisions and alliances. This helps avoid clashes and inefficiency.
- **Identifying** where and to what degree **local divisions** should be encouraged to take the lead in expressing and managing diversity.
- Getting a **cultural balance** in particular areas of strategic and tactical decision-making.
- **Leading from the top** with behaviours that signal the valuing of cultural diversity.

Activity

Read Willcocks (2021a) Chapter 3, in particular sections 3.1 and 3.2, which have additional information on culture, points and cases.

1. Make notes on the criticisms of the context, cluster and dimensions approaches.
2. Make notes on the Trompenaars (1993) approach described in Section 3.2. Define the dimensions of the approach and criticisms of the approach.
3. Look at your own country and plot your own culture according to Hofstede's five dimensions.
4. How useful is this for understanding behaviour at work in your country? If you were doing business with a US company, what cultural differences would you need to take into account compared to doing business with a company from mainland China?

3.3 Languages

Language influences culture. It is how we communicate with each other both in the spoken and unspoken form and it is also how we perceive the world. Some countries have more than one language and distinct culture. Canada, for example, has both an English-speaking and a French-speaking area – both with their own cultures. Belgium is divided into Flemish and French speakers, and four different languages are spoken in Switzerland. Chinese is the mother tongue of the largest number of native speakers (20 per cent), though English is the most widely spoken language in the world. For native speakers, six per cent speak English, five per cent Hindi, five per cent Spanish, four per cent Arabic and four per cent Russian. However, 56 per cent of the global population still speak other languages, often in addition to these six major languages.

Many multinationals have adopted English as the official corporate language, to enable knowledge sharing and communication across borders, not least with customers, suppliers and fellow employees. But note that, even though English is the main global business language, using English as a language in a business meeting can still create problems.

People from different cultures may understand the same words differently.

Why is unspoken language important? Think for a moment about how you stand when you are talking with another person. People in North America and Western Europe usually stand about an arm's length away. But in Latin America, people tend to stand much closer together. Now, what happens in a business meeting between someone from Brazil and someone from Canada, for example? The Brazilian might try to stand at their customary distance causing the Canadian to take a step backwards because their personal space has been invaded. The Canadian may be annoyed at the Brazilian for standing so close, and the Brazilian may interpret their response as aloofness. The meeting is already off to a bad start. Similarly, consider the circle you might make with your thumb and forefinger. In the USA, you have signalled a positive response, but if you make the same gesture in Greece, you have just insulted someone.

Activity

Read Willcocks (2021a) pp.81–82 section 3.3.

1. What do you see as the value of being a multilingual employee?
2. You are not Indian and are having a meeting with a businessperson from Mumbai in India. What would you see as the likely communication challenges? How would you deal with these?

3.4 Religion and ethics

3.4.1 Religion

Religion is another important determinant of culture, especially in countries where a single religion is dominant. Religion is the systems of shared beliefs and rituals that are concerned with the realm of the sacred. Religions with the greatest number of followers today are (approximately):

Christianity	1.7 billion
Islam	1 billion
Hinduism	750 million
Buddhism	350 million.

You might also include Confucianism with these. While not strictly a religion, Confucianism influences behaviour and shapes culture in many parts of Asia. Closely related to religion are ethical systems, or sets of moral principles or values that guide and shape behaviour. So, you might think of Christian ethics or Islamic ethics.

Most followers of Christianity live in Europe, the Americas or other countries settled by Europeans. Christians are divided into Roman Catholics, those who belong to the Orthodox Church and Protestants. Muslims are found in more than 35 countries, particularly in the Middle East. Islam is an all-embracing way of life – prayers take place five times a day, women are expected to dress in a certain manner, and pork and alcohol are forbidden. How does Islam affect business? The Koran, which is the sacred book for Islam like the Bible is for Christianity, supports free enterprises and legitimate profits, and the right to protect private property, but advocates using profits in a righteous, socially beneficial manner. The central tenets of Hinduism, which is mainly based in India, are spiritual growth and development. Many Hindus believe that the way to achieve nirvana is through material and physical self-denial.

Hinduism creates interesting challenges for companies. For example, because the religion emphasises spiritual rather than individual achievement, the drive for entrepreneurial behaviour so common among Protestants, for example, is not present. So a devout Hindu may not see promotion or additional responsibilities as being desirable. Buddhism's followers are located mainly in central and southeast Asia, China, Korea and Japan. Buddhism stresses spiritual achievement and the afterlife above involvement in this world. As with Hinduism, there is a lack of emphasis on entrepreneurial behaviour.

Confucianism is practised mainly in China and teaches the importance of attaining personal salvation through right action. Moral and ethical conduct is important, as is loyalty. What do the principles of Confucianism mean for business? The key principles of the ideology – loyalty, reciprocal obligations and honesty – could translate into making the costs of doing business lower.

A knowledge of religions is crucial even for non-religious managers. Religious beliefs and activities affect business through religious festivals, daily and weekly routines that vary across religions (e.g. prayer times, sacred days, fasts), and activities and objects with symbolic values.

For example, in India cows are holy in Hindu religion and may not be disturbed or eaten. Some objects or practices are taboo or banned – for example, Muslims are not supposed to eat pork. Recall the international furore over the Danish newspaper, which published cartoons depicting the Muslim prophet Mohammed. Religious differences, more than any other differences, tend to raise emotions, and thus are challenging for businesses to handle. Showing respect for other religions and associated values will help you avoid conflict and create a basis for doing business. An individual's religion may also help shape his/her attitude towards work and entrepreneurship.

3.4.2 Ethics

Ethics refers to the principles of right and wrong, standards and norms of conduct governing individual and company behaviour. Ethics are not only an important part of informal institutions but are also deeply reflected in formal laws and regulations. Business ethics are the accepted principles of right or wrong governing the conduct of business people. An ethical strategy is a course of action that does not violate these principles.

Managing ethics overseas is challenging because what is ethical in one country may be unethical elsewhere. How should you deal with ethical dilemmas that arise when operating internationally? The Friedman doctrine argues that the only responsibility of business is to increase profits. Friedman (1970) claimed that as long as the company stayed within the letter of the law, ethics did not enter the equation. So, in other words, he would argue that it is not the responsibility of a company to take on social expenditures beyond what the law mandates, and what is required to run a business efficiently. What Hill (2021) calls the **naïve immoralist** approach argues that if a manager of a multinational company sees that companies from other countries are not following ethical norms in a host country, that manager should ignore the norms as well. Peng and Meyer (2019) suggest three approaches:

- **Ethical relativism** follows the saying 'When in Rome, do as the Romans do'.
- **Ethical imperialism** refers to the absolute belief that 'There is only one set of ethics and we have it'.

- Companies often run into problems adopting either of these two approaches. Therefore Donaldson (1996) suggests a '**middle of the road**' approach in international business by observing three principles when overseas – respect for human dignity and human rights, respect for local traditions, and respect for institutional context. In practice these principles may clash in specific circumstances, leaving the business manager to behave as diplomatically as he/she can in the prevailing situation.

Ethics provides a useful bridge between culture, language, religion and the subject of a major way forward – corporate social responsibility – which we will now look at.

Activity

Read Willcocks (2021a) Chapter 3, pp.82–85, sections 3.4 and 3.5.

1. Assess the limitations of taking an ethical imperialist or ethical relativist approach when doing business in foreign countries
2. Write down what you see as the ethical 'rules of conduct' for a company whose operations are impacted by the informal institutions of a foreign country, for example United Arab Emirates To help you, have a look at the Wikipedia entry for the UAE: https://en.wikipedia.org/wiki/United_Arab_Emirates

3.5 Corporate social responsibility in international business

How can companies deal with the ethical dilemmas that arise when operating internationally? A major approach is corporate social responsibility (CSR), defined as the consideration of, and response to, issues beyond the narrow economic, technical and legal requirements of the company to accomplish social benefits along with the traditional economic gains the company seeks.

A stakeholder view of the company sees a business as responsible not just to its shareholders for its performance, but also to a much wider constituency. There are primary stakeholder groups on whom the company directly relies for its survival and prosperity – managers, employees, customers, shareholders, governments. There are also secondary stakeholder groups who do not engage in transactions with the company, but who influence or are affected by the company, though they are not essential for its survival. As a result of rising global concerns and the stakeholder view, companies increasingly develop CSR **triple bottom line strategies ('profit, people, and planet')** that take into account their economic, social and environmental performance. International businesses are faced with at least four major CSR concerns:

- The environment is currently a high profile topic, especially the irreversible damage that man-made pollution is causing. A key concern is sustainability, defined as the ability to meet the needs of the present without compromising the ability of future generations to meet their needs. Because many countries are establishing strong environmental regulations to try to limit further damage, companies are having to adopt new, often costly measures to abide by the laws. For example, new regulations may be forcing your company to take costly steps to stay within the law. Should you shift your production to another country where the laws do not exist, or are only loosely enforced?

Activity

Read Willcocks (2021a) Chapter 3, pp.85–90, sections 3.6 and 3.7 on this subject.

1. Make notes on the pressures on multi-national enterprises (MNEs) to lower their standards on the environment.
2. Explain the following terms: triple bottom line strategy; tragedy of the commons; pollution havens.

- **Employment practices** frequently present ethical dilemmas. Suppose work conditions in a host country are inferior to those in the home country. Which standards should be applied – the home country standards or the host country standards? Nike found itself in the midst of a huge controversy in the mid-1990s when it was reported that the working conditions at some of its sub-contractors were poor.

  While neither the sub-contractor nor Nike was actually breaking the law, there was strong reason to suspect that workers were being exploited. Nike was forced by public pressure to establish a code of conduct for all of its sub-contractors, and implement a monitoring system to ensure that the code was followed. The pressure to lower conditions in foreign operations is particularly strong with 'footloose plants' that are labour intensive and can easily relocate when local regulations get tighter. Another problem area is where an MNE buys products or components from foreign companies. MNEs like Adidas (see Peng and Meyer, 2011, In Focus 10.4) sometimes introduce standards of engagement on their suppliers. These are written policies and standards for corporate conduct and ethics. But what happens if suppliers fail to meet standards or provide misleading evidence?
- **Human rights**: Human rights and freedoms are not respected in all countries. Think about the apartheid system that denied basic political rights to black people in South Africa, for example. Should companies do business in countries with repressive regimes? Some people argue that the presence of multinational companies actually helps bring change to these countries. Others, however, argue that some countries like Myanmar, which has one of the worst human rights records in the world, are so brutally repressive that no investment can be justified.
- **Corruption:** Is it necessary to be ethical when dealing with corrupt government or individuals? This is something companies have to consider. At what point does 'gift giving' become bribery, for example? From a government perspective, bribery is invariably not allowed. The Organization for Cooperation and Development (OECD) passed an anti-bribery measure in 1997, which obligates member states to make the bribery of foreign public officials a criminal offence. Despite laws like these, bribery continues to be a common practice for some companies. In fact, some economists believe that in certain cases speed payments, or payments made to speed up approval for business investments, can be justified, for example, if they enhance public welfare by creating jobs. Others argue, however, that corruption can become ingrained as a way of doing business, and hard to stop if it is part of a country's way of getting things done.

Activity

Read Willcocks (2021a) pp.87–88, section 3.6 again.

1. Make notes on illustrative examples where companies have run into problems on environment, employment practices, human rights, and corruption.
2. Find a foreign multinational that operates in your country. Search on the internet. Using its most recent annual report – and noting any media stories – assess how well it does on these four areas.

3.5.1 Institutions and CSR strategies

What are the moral obligations of companies operating internationally? You can guess that the formal and informal institutions operating in a country greatly influence the types of CSR strategies companies can adopt, and the levels of success experienced. In liberal market economies like the USA and the UK, companies have a high discretion over their activities. So far as they undertake CSR, it will be done as explicit corporate activities undertaken voluntarily as policies, programmes and strategies, with the extent of these activities dependant on the expectations of different stakeholders of the company. In more coordinated market economies, for example in Germany and Scandinavia, much more implicit CSR takes place, with CSR being part of the fabric of the legal, political, and social and cultural institutions, and indeed may not only be morally demanded but legally demanded (e.g. in Germany health care benefits must be paid for all those employed for more than 20 days a month). Note, however, that among developed countries in particular there has been some convergence towards more CSR regulation.

Do companies have a responsibility to take into account the social consequences of their actions when they make business decisions? Should companies always choose the path that has both good economic and good social consequences? You might answer yes – companies have a social responsibility simply because it is the right way to operate. Many people believe that companies need to give something back to the societies that have made their success possible. Some companies, however, do not share this view. Willcocks (2021a) Chapter 3 section 3.7 suggests that companies often adopt one of four different responses to ethical challenges – reactive, defensive, accommodative and proactive – and gives worked examples in the text which you will need to understand. The spirit of CSR is better captured by adopting a proactive strategy, embracing the triple targets of profit, people and planet.

Activity

Refer to Willcocks (2021a) Chapter 3, pp.88–90, sections 3.7 and 3.8.1.

1. Describe the four strategies an international business can adopt on CSR.
2. Give examples of each strategy in action, and assess the advantages and disadvantages of each strategy.
3. What is stakeholder analysis, who are the firm's main stakeholders, how is stakeholder analysis related to CSR strategies?

Sometimes, it can very difficult for companies to decide how to behave in some situations. Managers will be influenced by their personal ethics and cultural perspective, which may or may not be appropriate in a given situation. However, there are several things that managers can do to be sure that ethical issues are considered when decisions are made:

- Companies can hire and promote people with well-grounded personal ethics.
- Companies can build an organisational culture that places a high value on ethical behaviour. To develop this, companies need to articulate values that place a strong emphasis on ethical behaviour. Some firms do this by establishing a formal code of ethics. Once a code has been developed, leaders need to emphasise it and act on it. Companies can encourage employees to adopt the code by offering incentives and rewards to those employees who behave in an ethical manner.
- Companies can make sure that leaders articulate the rhetoric of ethical behaviour and act in a manner consistent with that rhetoric.
- Managers can develop moral courage. Companies can strengthen the moral courage of employees by committing themselves not to retaliate against employees who exercise moral courage, say no to superiors or otherwise complain about unethical actions.
- Companies can put decision-making processes in place that require people to consider the ethical dimension of business decisions.

Activity

Read the case study 'Marks and Spencer and corporate social responsibility' (VLE Chapter 3).

1. Why is the plan A agenda so important to Marks and Spencer?
2. What do you see as the disadvantages and risks of giving 'how we do business' such a central place in the company's profile?
3. What could the company do even better?
4. Do you think the company's approach is particularly profitable? How?

3.6 CSR and sustainability

Sustainability has become a critical component of corporate social responsibility approaches in recent years, especially in the face of climate change challenges. The idea here is that businesses must support wider sustainable development beyond their own profit goals. A 1987 report by the World Commission on Environment and Development defined sustainable development as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

Willard (2012) has suggested a five-stage sustainability journey for business enterprises. The stages are:

1. pre-compliance
2. compliance
3. beyond compliance
4. integrated strategy
5. purpose/passion.

According to this framework, companies evolve from an unsustainable model of business (stages 1, 2 and 3), to a sustainable business framework (stages 4 or 5). Executive thinking also evolves from positioning 'green', 'environmental', and 'sustainable' initiatives as expensive and bureaucratic threats in the early stages, to seeing them as catalysts for strategic growth in the later stages (see Willard, 2012).

By stage 4 the firm has transformed its business model into a sustainable 'borrow-use-return' design. This is to help to build a '**circular economy**'. A circular economy is one that is restorative and regenerative by design, and which aims to keep products, components and materials at their highest utility and value at all times, distinguishing between technical and biological cycles (see Willcocks, 2021a, Chapter 3, p.93, figure 3.1). This involves practices such as recycling, refurbishing, servicing rather than disposal, with the focus on reuse and minimising waste.

Driven by a passionate, values-based commitment to improve the well-being of the company, society, and the environment, a Stage 5 company would help to build a better world because it is the right thing to do. (Stage 4 companies do most of the things a Stage 5 company does but 'do the right things' in order to become successful businesses).

Activity

Read Willcocks (2021a) Chapter 3, pp.91–94, section 3.8.2.

1. Make sure you understand the five-stage sustainability framework a company can adopt.
2. Referring to figure 3.1, p.93, make sure you can explain the concept of 'the circular economy.'
3. Do you think a multinational, for example Tencent, IBM or Singapore Airlines, that carries out a wider stakeholder analysis and adopting the sustainability journey will ultimately be more or less profitable?

3.7 Dealing with corruption

This is another part of corporate social responsibility. How do international businesses deal with the challenges of experiencing differing degrees of corruption in countries and business practices across the world?

How extensive is corruption, internationally? According to the Transparency International Corruption Perceptions Index, in 2019 a majority of countries were showing little or no improvement in tackling corruption. According to Transparency International, businesses and individuals spend in excess of $400 billion a year worldwide on bribes related to government procurement contracts alone. It suggests that reducing big money in politics and promoting inclusive political decision-making are essential to curbing corruption. Looking at 180 countries and their perceived levels of public sector corruption, the report found more than two-thirds of countries scoring below 50 out of 100 (where 100 is 'very clean'). No country recorded a perfect score, the highest being 87.

Corruption occurs on a large scale in markets and in transactions between businesses. Cuervo-Cazurra, (2016) has provided a neat framework for analysing corruption, and the points of leverage for governments and companies wanting to behave more ethically, to which you are referred now (see Willcocks, 2021a, pp.96, figure 3.3). This identifies the causes of corruption, in terms of demand for and supply of bribes, and low risk and punishments from behaving corruptly. If proper controls and punishments are put in place at government and company level, it is possible to gain more desirable outcomes in terms of country development and company profitability.

Poor corruption governance by a company can be very costly, leading to business losses, reputational damage, higher costs, deadlines not met, and barriers to innovation – as just some examples. There are many ways forward, including:

- tighter national and international rules, policing and more certain higher punishments
- non-state actors publishing guidelines and standards
- clearer, detailed corporate directives and their policing
- instilling stakeholder values militating against corruption.

Activity

Read Willcocks (2021a) Chapter 3, pp.94–97, section 3.8.1.

1. Why do you think corruption is so widespread across countries and in international business?
2. Your company is bidding to win an oil pipeline construction contract in Russia. You are aware that there are three other consortia bidding for the same work. There are a number of options including working with a Russian construction company, or with one of the other consortia competing for the business. You are also aware that bribery is frequently present in such negotiations and final contracts. What corporate policy and way forward would you recommend?
4. What actions can be taken to lower the corruption levels in international business?

3.8 Key concepts

The key concepts in this chapter are:

- culture
- context, cluster and dimension approaches to culture
- collectivism and individualism
- main types of religion
- ethics
- ethical dilemmas
- five corporate attitudes to ethics
- corporate social responsibility (CSR)
- reactive, defensive, accommodative and proactive CSR strategies
- triple bottom line
- sustainability journey
- dealing with corruption.

3.9 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define what culture is and articulate two of its manifestations, namely language and religion
- discuss how cultures systematically differ from each other
- explain how language competences shape intercultural interactions
- explain how religions shape cultures
- describe the importance of ethics
- summarise corporate social responsibility challenges faced by companies operating in the global economy
- discuss how institutions influence companies' corporate social responsibility activities and sustainability practices

- describe forms of corruption in international contexts, and suggest counter-policies
- participate in leading debates about culture, social responsibility and sustainability
- draw implications for management action.

3.10 Test your knowledge and understanding

Read the case study 'Alstom in Saudi Arabia and China' (VLE Chapter 3).

1. If you were invited to a party in Saudi Arabia, how would you behave? What would you tell an Indian colleague who is a vegetarian?
2. Do you think it is necessary or appropriate to join in the drinking when being invited to a business party in China?
3. How would you treat your Saudi Arabian or Chinese colleagues at your own company official party?
4. Alstom is an engineering company looking for new contracts all over the world. What should its CSR and anti-corruption policies be in Saudi Arabia and China?
5. Will it secure profitable contracts if it adopts your recommendations?

3.11 Sample examination question

'Informal institutions, particularly culture and ethics, are highly influential factors that shape the conduct of international business.' Discuss this proposition as follows:

a. Outline two major theories of culture and assess their relevance and limitations when applied to the conduct of international business.

b. Describe and assess the relevance of the main approaches to ethics in international business

c. Describe what corporate social responsibility (CSR) is, the main approaches to CSR that international businesses take, and the main challenges that CSR seek to deal with.

Part 2: Business across borders: the foundations

Notes

Chapter 4: International trade and investment

4.1 Introduction

Free trade refers to a situation where a government does not attempt to influence through quotas or tariffs what its citizens can buy from another country or what they can produce and sell to another country. Economists have debated the merits of free trade for centuries. You probably do not need trade theories to explain some patterns of trade – it's easy to see why Saudi Arabia exports oil and Brazil exports coffee, but it's much harder to explain why Switzerland exports watches and pharmaceuticals or why Japan exports consumer electronics. Why does Ford assemble cars made for the US market in Mexico, for example, while BMW and Nissan manufacture cars for US citizens in the USA?

In this chapter we look at the major classic and modern theories of trade. We then review how the governments and national institutions that we looked at in Chapters 2 and 3 regulate and shape MNE activity around the world and, through this lens, look at the fair trade versus protectionism debate.

Given that MNEs do make foreign direct investments (FDIs), why do they do so and under what conditions can these investments be successful?

We discuss the ownership, locational and internalisation advantages that companies may enjoy when making such FDIs, how governments assess the costs and benefits of FDIs into their countries, and the sorts of policies they may undertake to ensure FDI is controlled and beneficial to the host country.

4.1.1 Aims of the chapter

The aims of this chapter are to:

- establish the relevance of three classical and three modern theories of trade
- identify how national governments regulate and attempt to control international trade and its impacts on a country
- provide a structure for debating how free trade and protectionism can affect stakeholders, especially host countries, home countries, MNEs, customers and producers
- establish the main theories and strategies that support or inhibit an MNE making direct foreign investments in a country
- explain the main challenges to a host country when faced with foreign direct investment (FDI), and the main challenges and considerations for an MNE making those investments.

4.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- describe and assess the relevance of classical and modern theories of trade
- explain the role of governments in regulating and restraining international trade

- debate the evidence on whether free trade or protectionism provide net advantages to host countries, home countries, consumers, domestic producers and MNEs making foreign direct investments (FDIs)
- discuss the major theories and conditions under which an MNE strategy of FDI makes business sense
- assess the costs and benefits of FDI from a host-country perspective and understand the actions host countries can and may take with regard to FDI
- assess and make recommendations on the challenges MNEs face when undertaking international trade and FDI.

4.1.3 Essential reading

Davies, H. and P. Ellis 'Porter's competitive advantage of nations', *Journal of Management Studies* 37 2001, pp.1189–1215.

Willcocks, L. *Global business: strategy in context*. (Stratford-upon-Avon: SB Publishing, UK, 2021a) Chapter 1, pp.27–38, sections 1.7 to 1.10 and Chapter 6, pp.165–71, sections 6.3 to 6.4.

4.1.4 Further reading

Buckley, P. et al. 'The internalisation theory of the multinational enterprise: A review of the progress on a 30-year research agenda', *Journal of International Business* 40 2009, pp.1563–80.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapters 5 and 6.

4.1.5 References cited

Dunning, J. and S. Lundan *Multinational enterprises and the global economy*. (Cheltenham: Edward Elgar Publishing, 2008) second edition.

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Porter, M. 'The competitive advantage of nations', *Harvard Business Review* 68(2) 1990, pp.73–98.

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Vernon, R. 'International investments and international trade in product life cycle', *Quarterly Journal of Economics* May 1966, pp.190–207.

Reich, R.B. 'Who is Us? Across the United States, you can hear calls for us to revitalise our national competitiveness', *Harvard Business Review* 68(1) 1990, pp.53–64.

Willcocks, L. *Global business: management*. (Stratford-upon-Avon: SB Publishing, 2021b).

World Trade Organisation *World trade statistical review*. (Geneva: WTO, 2019).

4.1.6 Synopsis of chapter content

Introduction to classical and modern theories of trade; national institutions and relationship to international trading; debates on free trade and government interventions; MNES and FDI; FDI and the role of government.

4.2 Classic trade theories

You need to be familiar with three classic theories and be able to critique them. Peng and Meyer (2019) and Willcocks (2021a) point to three main theories – you need to read and understand them in detail.

- **Mercantilism**: The main idea behind 16th-century mercantilist philosophy is to encourage exports and discourage imports. To achieve this, you limit imports through tariffs and quotas and maximise exports through government subsidies. The more modern version of mercantilism is protectionism, where a country actively protects its domestic businesses from imports while promoting exports, for example China in 2008–13 kept the exchange rate of the remnimbi low by doing this. From 2016 the USA also sought to become more protectionist in both posture and practice. Thus the two most powerful economies in the world had by 2021 much more domestic focused, less liberal trade policies.
- **Adam Smith and absolute advantage**: Smith argued, in his *The wealth of nations* (1776), that trade without government intervention could be beneficial to countries if each country produced and exported those products in which it was most efficient or, in his words, where countries had an absolute advantage. The theory here is that it is better for a country to become most efficient at producing what it is best at producing, and trade with other nations in exchange for goods that those other nations are best at producing.
- **Ricardo and comparative advantage**: In 1817, Ricardo argued that it still made sense for a country to specialise in the production of those goods that it produces most efficiently and to buy goods that it produces relatively less efficiently from other countries, even if this meant buying goods from other countries that it had an absolute advantage in (i.e. that it could produce more efficiently itself). The key issue here is opportunity cost. A key idea in all of this is productivity. Smith looked at absolute productivity differences between countries, while Ricardo looked at relative productivity differences. Eli Heckscher and Bertil Ohlin (Ohlin, 1933) extended Ricardo's work by suggesting that a country's comparative advantage is a result of differences in national factor endowments. The Heckscher–Ohlin theory argues that countries will export goods that make intensive use of factors of production like land, labour and capital that are locally abundant. At the same time, countries will import goods that make intensive use of factors that are locally scarce.

Activity

Read Willcocks (2021a) Chapter 1, section 1.7, pp.27–28, section 1.7 on this same subject.

Make notes on the strengths and weaknesses of each of the three classic theories.

Activity

1. Make sure you understand the idea of comparative advantage. Willcocks (2021a) p.28 provides the example of a student studying a degree. This example is worth understanding.
2. Consider your own country.
   a. What factor endowments does it have?
   b. Who are its three main trading partners, and what is traded between your country and those three nations in terms of imports and exports?
   c. Can you explain why this trade takes place? Look at this issue from your country's perspective.

4.3 Modern trade theories

Classic trade theories paint a static picture of the world, but, as we know, things move all too quickly these days! Willcocks (2021a) Chapter 1, pp.29–31, section 1.7 discusses three modern theories and their relevance:

- **Product life cycle**: Why are some products that used to be made in home countries now imported from other countries, especially less developed ones? For example, the UK used to be a major producer of textile products, but is no longer. Vernon (1966) suggested that as products mature both the sales location and the optimal production location would change. As these change, so too will the flow and direction of trade. Products move through different stages of their life cycle, and as they do, where they are produced and sold changes too. For Vernon, the product life cycle consisted of three stages: new, maturing and standardised. Moreover, there were three types of nations: lead innovation nation (in the 1960s he saw this as the USA), other developed nations, and developing nations. As demand for a new US product grew in other advanced countries, foreign producers would begin to produce the product, and then so would developing nations, who could produce it more cheaply. A criticism is that while this theory might have been valid in the 1960s, it has largely been overtaken by globalisation and integration of the world economy.
- **Strategic trade theory**: In an effort to resolve some of the shortcomings of earlier theories, researchers in the 1970s began to search for other explanations of trade. Strategic trade theory argued that because of the unit cost reductions that are associated with a large scale of output (economies of scale), some industries can support only a very few companies. Moreover, in some industries, to achieve economies of scale, companies have to have a major share of the world's market. The costs of developing new aircraft, for example, are so high that companies have to hold a significant share of the world market in order to gain economies of scale. There are reasons why there are only two makers of large commercial aircraft in the world. **First mover advantage** is an important concept here. Companies that achieve first mover advantages will develop economies of scale and create barriers to entry for other companies. This theory suggests

that government should support certain strategic industries so that they can gain first mover, hard-to-replicate advantages. Have a look at South Korea and China, for example, and ask yourself if their governments are exemplars of this theory.

- **National competitive advantage**: Why do some countries have certain industries that seem to be superior to those of other countries? In 1990, Michael Porter identified four factors that, he argued, promoted or impeded the creation of competitive advantage in an industry. The first factor Porter identified, called **factor endowments**, refers to a country's factors of production that can lead to a competitive advantage – things like a skilled labour force or infrastructure. **Demand conditions**, the second factor, refer to the nature of home demand for the industry's products/services. For example, sophisticated and demanding Japanese customers for iPods, console games and mobile phones have pressured Japanese consumer electronics companies to be highly competitive. The third factor, **related and supporting industries**, refers to the presence or absence of supplier and related industries that are internationally competitive and contribute to other industries. The fourth factor, **company strategy, structure and rivalry**, refers to the conditions in a nation that govern how companies are created, organised and managed, and the nature of domestic rivalry. When domestic rivalry is strong, there is greater pressure to innovate, improve quality, reduce costs and invest in advanced product features.

Activity

Refer to Willcocks (2021a) Chapter 1, section 1.7, pp.130–31:

1. Make a list of the four factors in the 'Porter diamond'.
2. Was Porter successful at increasing our understanding of trade patterns? Porter argued that a nation's success in an industry is a function of the combined impact of the four points on his diamond. He also suggested that government could play a role in supporting this success. There is some debate about the amount of evidence supporting his theory.

Activity

These newer trade theories are summarised in Willcocks (2021a) Chapter 1, section 1.7, pp.29–31.

1. Describe these three newer trade theories – product life cycle, strategic trade and national competitive advantage of industries.
2. Assess their relevance to international businesses. Look at their strengths, weaknesses and usefulness.
3. Using your own country as the example, think about the following questions:
   a. Establish your country's strategic industries and the extent to which they are supported by government.
   b. Apply the 'Porter diamond' model to your own country. Does it work? What does it leave out, or get wrong?

4.4 National institutions and international trade

Free trade refers to a situation where a government does not restrict what its citizens can buy from another country or what they can sell to another country. Many nations today claim to support free trade, but, in reality, most countries are only nominally committed to free trade. The global recession of 2008–09 led to an increase in protectionist policies in many countries. Countries intervene in markets in several ways.

- **Tariffs** are levied on imports that effectively raise the cost of imported products relative to domestic products. Tariffs are beneficial to governments because they increase revenues. They are also beneficial to domestic producers because they provide protection against foreign competitors by increasing the cost of imported foreign goods, though, of course, this means higher prices for consumers. There is general agreement that tariffs tend to favour producers and not consumers. They are often introduced as a result of special interest groups' abilities to influence political decisions. An interesting example has been the USA and China using tariffs against each other as part of a trade dispute during 2016–21, which is ongoing.
- **Subsidies** are government payments to domestic producers. Governments can give subsidies in various ways, including cash grants, low interest loans and tax breaks. They can help domestic producers compete against low-cost foreign imports and they can help them gain export markets. Some 21 countries were spending more than $300 billion a year on subsidies by 2010, a figure that was much higher by 2021, and spread across many more nations, given the rise of protectionist policies.
- An **import quota** is a direct restriction on the quantity of some good that may be imported into a country. In the USA, for example, there is a quota on cheese imports.
- **Voluntary export restraints** are quotas on trade imposed by the exporting country, usually at the request of the importing country's government. Import quotas and voluntary export restraints benefit domestic producers by limiting import competition, but they do raise price of imported goods.
- **Export tariffs and prohibitions**: Countries sometimes put a tariff on an exportable good, in order to ensure there is a sufficient supply domestically. For example, historically, China has placed such tariffs on some steel products and grain, because it needed these to support its building boom and feed its people.
- **Local content requirements** are another form of trade barrier where the government demands that some specific fraction of a good be produced domestically.
- **Administrative trade policies** are bureaucratic rules designed to make it difficult for imports to enter a country. The Japanese are known for this type of trade barrier, which can be very frustrating for companies trying to break into the market. Since 2008 Indonesia and Malaysia have limited imports to certain ports, and India has banned Chinese toys, citing safety concerns.
- **Anti-dumping policies** are imposed when goods are sold in a foreign market below their cost of production or when they are sold in a foreign market at below their fair market value, which is known as dumping. Dumping is a method by which companies unload excess production in foreign markets. To stop this, countries implement anti-dumping policies designed to punish foreign companies that are dumping and protect domestic producers from this type of unfair competition.

Activity

Read Willcocks (2021a) Chapter 1, section 1.8, pp.32–34. Also the case study 'Was China dumping excess steel production?' (VLE Chapter 4).

1. Was China dumping excess steel? What is the evidence?
2. Who benefitted and who was harmed by China's trade practices?
3. Were the EU and USA correct to impose anti-dumping duties? Give arguments for and against.

4.5 Government intervention and free trade: the debate

Is free trade always best? Many argue that economically and over the long term it is. For example, it is argued that free trade can increase a country's stock of resources and can also increase the efficiency of resource utilisation. If companies can sell to a bigger market, they can gain from the economies associated with large-scale production. Studies show that there is a link between more trade and economic growth. Countries that adopt a more open stance towards international trade tend to have higher growth rates than those that close their economies to trade. There may be times when restrictions on trade are counterproductive, for example, when they involve retaliation and trade wars, or efforts to further domestic policies. Special interests are not necessarily national interests.

But others argue that a country needs to protect its own domestic industries and also its new, emerging industries. One of the problems with the latter argument, though, is determining when an industry has grown up enough to stop government support. Others argue that, regardless of the economic arguments, protectionism can advance a country's political, social and environmental agenda. The following are the main arguments advanced for government intervention.

- Protecting home country job numbers and employment prospects.
- National security concerns are often evoked to protect defence-related industries in France, the USA and the UK, for example.
- Governments claim that trade barriers are sometimes necessary to protect consumers. For example, the European Union has limited imports of hormone-treated beef for many years, and this has been the source of a huge conflict between the European Union and the USA.
- Sometimes governments intervene in markets to retaliate against moves made by other governments. China has been under fire in recent years for failing to take proper steps against product and intellectual property piracy, and many nations have threatened to implement trade barriers against Chinese products if the practice isn't stopped. China initially responded to the threats with threats of increasing its own barriers to trade, although it subsequently backed off.
- Governments also argue that intervention in the market is necessary to support their foreign policy objectives. A country might, for example, extend favourable trade terms to a country with which it is trying to build a relationship or implement policies designed to punish countries. For example, in 2021 the USA still maintained trade embargoes against Cuba, Iran, Russia, and North Korea.
- It is argued that the best way to protect human rights in a country is to encourage it to trade. This will raise income levels, which generally means that human rights practices improve.

- Environmental and social responsibility arguments are sometimes used to start trade intervention against certain countries, for example, the USA banning shrimp imports from India, Malaysia, Thailand and Pakistan, arguing that their fishing techniques also trapped sea turtles, a protected species in US waters.
- Protecting infant industries and supporting strategic trade policies are common economic arguments for state intervention. They have been used extensively by developing nations in recent years, not least to justify protectionism. This, of course, may be counter-productive if it does not result in an infant industry becoming efficient and able to compete against international competitors.

Activity

Read Willcocks (2021a) Chapter 1, section 1.9, pp.34–36. Make notes on new points and cases.

Answer the following questions:

1. Since 2016, has your country become more protectionist? In what ways? Why?
2. How did the 2020–21 crises affect your government's trade policies? What have been the differences since the end of 2021?
3. Assess the advantages and disadvantages of your government intervening in international trade using:
    a. subsidies
    b. tariff barriers
    c. import quotas
    d. anti-dumping policies.

4.6 Foreign direct investment (FDI)

How do MNEs engage in international trade? Foreign direct investment, or FDI, occurs when a company invests directly in facilities to produce and/or market its products or services in a foreign country. Once a company undertakes FDI it becomes, by definition, a multinational enterprise or MNE.

There are two main forms of FDI. A **greenfield** investment involves establishing a wholly owned new operation in a foreign country. The second type of FDI is an **acquisition or merger** with an existing company in the foreign country. Most companies make their investments either through mergers with existing companies, or acquisitions. Companies prefer this route because mergers and acquisitions tend to be quicker to execute than greenfield investments, it is usually easier to acquire assets than build them from the ground up, and companies believe they can increase the efficiency of acquired assets by transferring capital, technology or management skills. See Chapter 9, below, for a detailed treatment of this topic.

The flow of FDI refers to the amount of FDI undertaken over a given period of time. Outflows of FDI are the flows of FDI out of a country, while inflows of FDI are the flows of FDI into a country. The stock of FDI refers to the total accumulated value of foreign-owned assets at a given time.

There has been a marked increase in both the flow and stock of FDI in the world economy. In 1975, the outflow of FDI was about $25 billion, and by 2008 it peaked at $2.2 trillion. Together, six countries accounted for almost 60 per cent of all FDI outflows from 1998 to 2006 – the USA, the UK, the Netherlands, France, Germany and Japan. By 2016 outflows had declined to $1.6 trillion but this still represented a massive financial presence abroad, even though this showed no signs of rising between 2017–20, and dipped notably during the 2020–21 crisis.

Activity

Read Willcocks (2021a) Chapter 6, sections 6.3 and 6.4, pp.165–71, then answer the following questions:

1. Why do you think FDI outflows – that is, companies investing in foreign countries – remain so large, despite recent trends towards de-globalisation? What are the advantages of investing abroad for multinationals? See Willcocks (2021a) section 6.3.
2. Why do you think there has been a slowdown in FDI in recent years? Willcocks (2021a) Chapter 1, section 1.10, pp.37–38, will help you here.

4.6.1 Why do companies become MNEs by engaging in FDI?

The answer to this question will help you understand how companies choose between the different foreign modes of entry – exporting, licensing, turnkey projects, franchising, joint ventures, fully owned subsidiaries – discussed in detail in Chapter 9. You have some answers already, but let's look further at a useful framework by Dunning and Lundan (2008). They argue that companies will undertake FDI if there are ownership advantages, locational advantages or internalisation advantages. This is known as Dunning's OLI framework. A useful reference point now is Willcocks (2021a) Chapter 6, pp.167–68, figures 6.1 and 6.2, which illustrate the advantages of ownership, location and internalisation.

Ownership advantages: These are resources of the company transferable across borders that enable the company to obtain competitive advantage abroad. You can read more about such capabilities in Willcocks (2021a) Chapter 6, pp.166–69, section 6.3.

Locational advantages: Location-specific advantages which are available to the company in foreign locality conditions that it would not enjoy at home (e.g. raw materials, human resources). These are dealt with in more detail in Chapters 9 and 12, but here we will mention four types of locational advantages:

- **Markets**: There are often advantages in being close to existing or potential markets – this is one reason why so many companies have sought to set up in the rapidly developing, hugely populated country of China.
- **Resource endowments**: The locality may have specific resource advantages, for example, in land, labour, weather and infrastructure that the MNE can tap into. For example, in recent years Chinese MNEs have been seeking natural resources around the world in oil, gas, minerals and also agriculture and land.
- **Agglomeration** refers to the location advantages arising from the clustering of economic activity in certain locations. Think of Silicon Valley in the USA and the cluster of suppliers, manufacturers, research companies and market leaders there or of the City in London as a global financial centre.
- **Institutions**: A country may well offer tax advantages, business opportunities, legal recourse, subsidies, access and the like in order to attract FDI from multinationals. For information about assessing location attractiveness see also Chapter 12.

- **Internalisation advantages**: These arise if the MNE can organise activities better and more cheaply internally, within the MNE, than by using a third party that incurs prohibitive transaction costs – see also Chapter 9 (transaction costs) and Chapter 12 (sourcing) where this issue is discussed in depth. You are recommended to read Willcocks (2021a) pp.166–69, section 6.3, and note how the advantages and disadvantages of these options compare, as a preliminary to studying later chapters in this guide.

Activity

The OLI framework (ownership, location and internalisation) and the advantages accruing are shown and discussed in Willcocks (2021a) pp.167–69. Read this now.

1. Make notes on the ownership advantages and examples of these.
2. Make notes on the location advantages and examples of these.
3. Make notes on the internalisation advantages and examples of these.

4.7 Governments and FDI

How does a government's attitude affect FDI? You can think of ideology towards FDI as being on a continuum where at one end is the radical view that is hostile to all FDI, and at the other end is the non-interventionist principle of free market economies. In between these two extremes is pragmatic nationalism. In recent years more countries have adopted more friendly FDI policies, however, between 2020–21 in particular, countries not only retained, but in many cases strengthened institutions that restrict and regulate FDI, such as the following:

- **Outright banning**, such as nationalisation of the oil industry in Venezuela early in the 21st century; US government's 2019 restrictions on Chinese-based hi-tech company, Huawei.
- **Case-by-case approval** of FDI with registration and approval requiring a range of conditions and negotiations to be gone through.
- **Ownership requirements** which disallow full foreign ownership but allow joint ventures perhaps, or minority foreign ownership (e.g. for security reasons the USA does not allow majority foreign ownership of domestic air transportation).
- **Local business regulations** will have to be complied with and may be restrictive if applied inflexibly.
- **Local content requirements** that a certain part of the value of the goods made or sold in the country should originate from that country (e.g. European countries introduced legislation demanding that Japanese auto-makers use components that had partly originated in the host country rather than being made wholly in Japan and assembled in the host country).

Activity

Clearly some governments are very suspicious of FDI and need to weigh up the costs and benefits of FDI to their country. Look at Willcocks (2021a) Chapter 6, p.170, figure 6.3, and make notes on the following:

1. What are the benefits of FDI to your country as the host country?
2. What are the drawbacks of FDI to your country as the host country?
3. What does your country do to regulate FDI in the banking sector, the telecommunications industry and the car manufacturing sector? Why does it have these policies?

4.8 Key concepts

The key concepts in this chapter are:

- free trade
- protectionism
- theory of absolute advantage
- theory of comparative advantage
- first-mover advantage
- theory of national competitive advantage of industries
- strategic trade theory
- resource endowments
- foreign direct investment (FDI)
- Dunning's OLI framework
- government, institutions and FDI regulation.

4.9 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- describe and assess the relevance of classical and modern theories of trade
- explain the role of governments in regulating and restraining international trade
- debate the evidence on whether free trade or protectionism provide net advantages to host countries, home countries, consumers, domestic producers and MNEs making foreign direct investments (FDIs)
- discuss the major theories and conditions under which an MNE strategy of FDI makes business sense
- assess the costs and benefits of FDI from a host-country perspective and understand the actions host countries can and may take with regard to FDI
- assess and make recommendations on the challenges MNEs face when undertaking international trade and FDI.

4.10 Test your knowledge and understanding

1. In considering the various theories of international trade, ask yourself what a manager can learn from such theories of trade, and the types of government intervention. What practices should the practising international manager adopt when trying to operate in a foreign country?
2. Peng and Meyer (2019) suggest the following as recommendations for management action on FDI:
    - carefully assess whether FDI is justified in light of other foreign entry modes such as outsourcing and licensing
    - pay careful attention to the location advantages in combination with the company's strategic goals
    - be aware of the institutional constraints and enablers governing FDI and enhance legitimacy in host countries.

Are there additional recommendations you would make to an MNE looking to make FDIs into a country?

3. Have a look at the online video: 'How to enrich a country: Free trade or protectionism'.

   See: www.youtube.com/watch?v=5ITyd1Pzek0

   The video argues that Free Trade has won the argument.

   1. Do you agree or disagree?
   2. What is the argument for free trade?

4.11 Sample examination question

'International trade needs to be both understood and regulated.' In light of this statement:

1. Describe and assess strategic trade theory and Porter's diamond of national competitive advantage.
2. Outline and assess whether the Dunning OLI framework explains satisfactorily the occurrence of foreign direct investment.
3. What can a host government do to support, or slow, FDI and foreign trade?

Chapter 5: Multilateral organisations and regional integration

5.1 Introduction

Are you familiar with GATT, the WTO, the World Bank and the IMF? These are multilateral institutions set up by several collaborating countries to deal with common difficulties. Are you also familiar with NAFTA – the North American Free Trade Agreement – and that it has recently been superseded by USMCA? How about the European Union (EU)? Do you know what these agreements are and why they are important to international companies? Both NAFTA/USMCA and the EU are forms of regional economic integration – agreements between countries in a geographic region to reduce tariff and non-tariff barriers to the free flow of goods, services and factors of production between each other.

Despite problems, and the renegotiation, NAFTA had significantly boosted trade and investment among its members. In South America, the prominent regional deals are Andean Community and Mercosur. Regional integration in the Asia Pacific is also taking place through ASEAN (Association of South East Asian Nations), SAFTA (South Asian Free Trade Association) and the GCC (Gulf Cooperation Council). Such agreements, and there are many more, are designed to promote free trade and, depending on the level of integration, allow the factors of production to move freely between countries.

In this chapter we look at the institutional developments supporting global integration and governance. We start with types of economic integration.

5.1.1 Aims of the chapter

The aims of this chapter are to:

- provide descriptions of the institutions of the global trade and monetary systems, including GATT, WTO, World Bank and IMF
- identify the challenges these institutions face in the contemporary global environment
- explain the nature and rationale for regional and bilateral economic integration, with reference especially to Europe, the Americas, and Asia Pacific, including descriptions and assessment of the major economic institutions in these regions
- establish the parameters of the debate on further multilateral policy forums and institutions and the implications for international business management.

5.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- explain the multilateral institutions of the global trade system and their current challenges
- describe the multilateral institutions of the global monetary system and discuss their current challenges
- describe the advantages and disadvantages of regional and bilateral economic integration in Europe, the Americas and the Asia Pacific

- discuss the EU's political institutions and how and why the institutional framework created by the EU is pivotal for business
- participate in debates about further multilateral policy forums and institutions contributing to economic integration
- outline the implications for management action.

5.1.3 Essential reading

Willcocks, L. *Global business: strategy in context.* (Stratford-upon-Avon: SB Publishing, 2021a) Chapter 2, sections 2.7 to 2.12, pp.53–72.

5.1.4 Further reading

Collinson, S., R. Narula and A. Rugman *International business*. (Harlow: Pearson Education, 2020) Chapters 16–20. This book provides the most thorough coverage of world economic blocs and intra-regional activity.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapter 8 is strong on European integration.

5.1.5 Synopsis of chapter content

Regional economic integration; multilateral trade and monetary systems; Europe and regional integration; regional integration in the Americas and Asia Pacific.

5.2 Regional economic integration

The idea behind regional economic integration is that without trade barriers, member countries will be better off. However, there is some concern that, as more countries become involved in regional agreements, the trading blocs will begin to compete against each other.

As you can see in figure 5.1, there are five levels of economic integration:

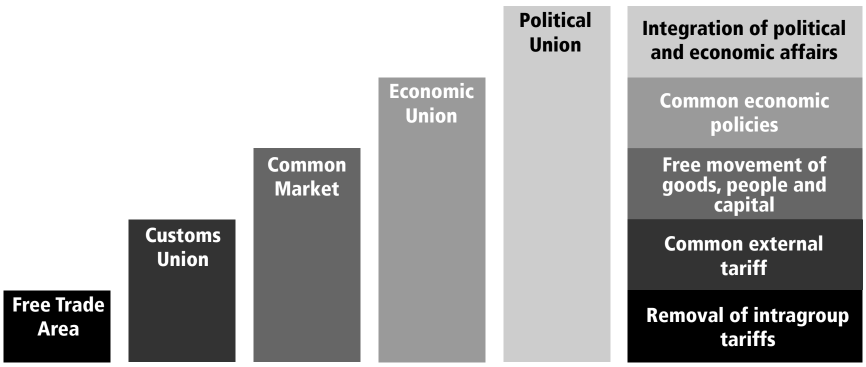

Figure 5.1 Types of regional economic integration

- A **free trade area** removes all barriers to the trade of goods and services among member countries, but members determine their own policies towards non-members.
- A **customs union** eliminates trade barriers between members and adopts a common policy towards non-members.
- A **common market** has no barriers to trade between members, a common policy towards non-members, and the free movement of the factors of production. This is a significant step up from a customs union, and requires members to cooperate on fiscal, monetary and employment policies. The EU was a common market for many years before moving to the next level of integration.

- The next level of economic integration is the **economic union** which involves the free flow of the factors of production between members, the adoption of a common external trade policy, a common currency, harmonisation of tax rates, and a common monetary and fiscal policy.
- In a **political union**, independent states are combined into a single union where the economic, social and foreign policy of members is coordinated. An example is the USA. The EU has potentially headed towards this level, but some members have insisted on limits to these ambitions.

Countries integrate for both economic and political reasons. We will see that, for various reasons, trade barriers still exist, despite the efforts of the World Trade Organisation (WTO). Regional economic integration offers countries a way to achieve the gains from free trade, at least on a limited basis, more quickly than would be possible under the WTO process. The political case for integration has two main points. First, by linking countries together, making them more dependent on each other, and forming a structure where they regularly have to interact, the chance for violent conflict and war decreases. Second, economic integration gives the bloc of countries greater power and influence and makes them much stronger politically when dealing with other countries than if they were to act independently.

Two key issues limit integration. First, while a nation as a whole benefits from integration, some groups may actually lose. Critics of NAFTA, for example, were concerned about the potential for job losses in the USA if companies shifted production to take advantage of Mexico's low-cost labour. From 2016, the US administration was more aggressive on these and other trade issues relative to Canada and Mexico, and indeed renegotiated the agreement in 2018 (see Willcocks, 2021a, Chapter 2, pp.58–60, section 2.9). Second, integration requires that countries give up some control over monetary policy, fiscal policy and trade policy. For example, most of the countries belonging to the EU have given up their currencies and adopted the euro instead.

Some economists point out that integration only makes sense when the amount of trade it creates is greater than the amount that it is diverting. Trade creation occurs when low-cost producers within a free trade area replace high-cost domestic producers, while trade diversion occurs when higher-cost suppliers within a free trade area replace lower-cost external suppliers.

We will look in more detail at some major regional and trading blocs below, but first we focus on the role of the main multilateral organisations that operate globally to assist trade and monetary policy.

Activity

Read Willcocks (2021a), section 2.7, pp.53–55.

1. Make further notes on the differences between a free trade area, customs union, common market, economic union and political union.
2. Identify whether your country belongs to an economic/political regional bloc. What type of grouping is it?
3. Why does your country belong to this grouping? Do you see drawbacks?
4. Would your country be better off in one of the other types of group or even going it alone?

5.3 The multilateral trade system

In the late 1940s the world community developed several institutions to facilitate international trade and political integration. These included the United Nations, the International Monetary Fund and the World Bank, together with the General Agreement on Tariffs and Trade (GATT), and its successor, the World Trade Organization (WTO).

GATT was created in 1948 to reduce the levels of tariffs among participating countries. In 1995 participating countries extended GATT by creating the WTO. The **WTO** is the main multilateral organisation involved in making rules for international trade and resolving trade-related conflicts between nations. It has both political and economic functions. Peng and Meyer (2019) suggest that in recent years it has focused on:

- Handling disputes constructively. One good example is the dispute between Airbus and Boeing involving the USA and Europe.
- Making life easier for all participants. This involves setting out a common set of rules for international trading partners. For example, the WTO's **principle of non-discrimination** means that a country cannot discriminate against some trading partners and benefit others.
- If you lower tariffs for one WTO member country you must do so for all WTO members (regional trade groups are an exception here).
- Raising incomes, generating jobs and stimulating economic growth. The essential role here is cutting trade barriers. There is a debate, however, about the environmental impacts of more trade, and how it is conducted and who benefits.

The WTO has six main areas, and does a lot more than GATT used to cover:

1. The umbrella agreement establishing the WTO.
2. The old GATT agreement covering international trade of goods.
3. A new agreement covering the trade in services – General Agreement on Trade in Services.
4. An agreement covering intellectual property rights – Trade-Related Aspects of Intellectual Property Rights.
5. Trade dispute settlement mechanisms.
6. Trade policy review for looking at an individual country's trade policies.

In recent years the WTO has undertaken two major initiatives:

- **Trade dispute settlement**: The WTO has a procedure to resolve conflicts between governments over trade-related matters. The WTO first facilitates negotiations between the parties, but if consultation fails, it establishes a group of experts to hear the evidence, write a report and adjudicate. A limitation is that the WTO does not have its own enforcement capability.
- **The Doha development agenda**, also called the Doha round, initiated in Qatar in 2001. This was the first time the participating countries in the WTO established the aim of promoting economic development for developing countries. The four aims were to:
    a. reduce agricultural subsidies in developed countries
    b. cut tariffs, especially in industries of interest to developing countries, (e.g. textiles)
    c. free up trade in services

d. strengthen intellectual property protection.

You might be able to guess which group of countries supported which aim. However, by 2003, numerous countries had failed to deliver on their promises of 2001. By the 2006 round in Geneva there was still little movement on global agreements, although, outside the WTO altogether, regional and bilateral (between two countries) agreements were accelerating, and have been since then. Advocates of bilateral Free Trade Agreements see them as a convenient substitute for global free trade.

It is worth noting common criticisms of the WTO. Willcocks (2021a) section 2.11, pp.68 and 69, lists nine criticisms. Note also the six responses to these criticisms (p.69).

Through 2019–21, the WTO faced challenges on multiple fronts. The organisation's Dispute Settlement Body (DSB) faced several systemic tests. Members questioned the governance processes of the WTO, with 2019 a particularly difficult year. There were multiple unsettled disputes between countries. As just one example, WTO ruling in China's favour on some issues, and against the USA, led some to believe the USA would threaten to leave the WTO. Finally, despite the proposals by some members to reform the WTO in 2018 (e.g. with respect to agricultural and industrial subsidies, state-owned enterprises, etc.), members appeared to be far away from finding common ground on which to start a serious discussion – let alone an eventual negotiation – on elements of WTO reform. The debates on reform continued during 2021.

5.3.1 Other multilateral organisations

While the WTO and IMF (see below) are the most important multilateral organisations, there are others, not least the United Nations, whose mission is to secure world peace. We can usefully organise these in terms of three agendas driving global collaboration and negotiation. These were all extended as a result of the 2020–21 pandemic and economic crises:

- **The development agenda**: As two examples, the World Bank supports major projects that otherwise would not get off the ground, particularly in developing economies. The European Bank for Reconstruction and Development serves transition economies, mainly in Central and Eastern Europe (see Willcocks, 2021a, p.70).
- **The climate change agenda**: A major global concern is the environmental impact of human activity. A major focus has been on the detrimental global warming effects of greenhouse gas emissions. The 1997 Kyoto protocol had developed countries pledging to cut GHG emission levels by six per cent from 1990 to 2012. Unfortunately, not much actually happened. The 2009 Copenhagen meeting of countries agreed that more action had to be taken, but resulted in the weak, non-binding Copenhagen Accord. This remains a difficult issue on which to make global progress. In December 2015, in the Paris Agreement, many countries made substantive commitments towards creating a sustainable low carbon future. These included keeping the rise in global temperature to below 2C above pre-industrial levels, and investing $100 billion to support this aim. By 2018, 195 countries had signed the agreement, but the USA announced its intention to withdraw from it. By 2021, under a different president the USA was prepared to sign the agreement again. Read more about this issue in Willcocks (2021a) pp.70–71.
- The financial sector regulation agenda: Bank crashes can harm not just the home country but can have adverse consequences internationally.

The Basel Committee for Bank Supervision disseminates minimum regulatory standards, revised in 2004 and known as Basel II. This established minimum requirements for liquidity and procedures for risk metrics. In the aftermath of the 2008 financial crisis these have been criticised as being inadequate. Some argue that national regulation of international banks is not enough. However, there is, as yet, no agreement as to how global bank supervision could be carried out. Read more about this issue in Willcocks (2021a) p.71.

Activity

Watch the Video 'Whats the difference between the IMF and the world bank?'

- www.youtube.com/watch?v=lN3qrFA4jXc

1. Make notes on what the IMF does and the major criticisms of the IMF.
2. Note what the World Bank does that is different.

5.4 The multilateral monetary system

The **IMF** is a multilateral organisation promoting international monetary cooperation and providing temporary financial assistance to countries with balance of payments problems. It has three primary activities on behalf of its 188 member countries:

- monitoring the global economy
- providing technical assistance to developing countries
- lending money to countries in financial difficulties.

The IMF's lending activity focuses on helping countries with severe balance of payment problems. The IMF acts as a lender of last resort, with loan repayments typically expected within one to five years IMF loans come with strings attached. IMF **conditionality** typically imposes conditions that require 'belt-tightening' by pushing governments to embark on reforms that they probably would not have undertaken otherwise. To attack inflation and government deficits, the IMF typically looks for cuts in government expenditure, among other things, in agreement with that government. In principle, the conditions imposed are also designed to ensure the country can repay its IMF loans. In the 1990s and early 2000s the IMF often went into action in emerging economies including Mexico, Russia, Indonesia, South Korea, Turkey and Brazil. The financial crisis of 2008 and subsequent events, for example the financial crisis in Greece, Spain, Ireland and Portugal from 2010–12, and the economic crisis of 2020–21 has led to renewed debates around the advantages and disadvantages of IMF conditionality. These are well worth understanding, together with the achievements of the IMF to date.

Activity

Read Willcocks (2021a) Chapter 2, sections 2.11 and 2.12, pp.63–73, then answer the following questions.

1. Assess the role of the IMF in the 1997 Asian financial crisis. What were the IMF's policy recommendations and their consequences? Were there better alternatives?
2. What are the main criticisms that can be made of the IMF?
3. What have been the IMF's main achievements?
4. What are the main criticisms often directed against the World Trade Organisation? How would you respond to these criticisms?

5.5 Regional integration examples: Europe

Faced with the inevitable limitations of global institutions, many countries have chosen to organise themselves into regional blocs to pursue joint economic and sometimes political objectives. It is useful for you to have a working knowledge of what the major economic blocs are and what they do, but you are not expected to know in detail the histories, institutions, workings and challenges of all the world's trading blocs. What you should focus on is a general knowledge of the names and coverage of the main blocs. Note also the reasons why they are set up and examples of the challenges they have to deal with. The best option then is to focus only on one you know really well and can cite details about. If your country is member of a regional bloc, or close to one, pick that one to focus on.

5.5.1 Regional integration in Europe

The European Union (EU) is the world's most integrated group of countries with 27 members (the United Kingdom formally left in January 2020 and reached a new trade agreement with the EU in December 2020). The EU single market is based on freedom of movement of goods, capital, people and services. This is implemented through harmonisation of regulation in some sectors, and mutual recognition of national regulation in others. The euro has become a common currency in 16 countries that have transferred their monetary policy to the European Central Bank. EU competition policy aims to ensure that a competitive environment is maintained in cases of mergers and acquisitions, cartels, collusion and state aid. Formal political structures of the EU resemble a government, yet national governments wield power through the European Council (for more information about the Council, see below). The decision-making processes in the EU are based on democratic principles, yet they often are far removed from the individual citizens in member countries. Enlargement creates not only benefits but also costs for existing EU members, who may be less enthusiastic to admit further members. The UK had an ambiguous relationship within the EU, grounded in its history and its political culture. For example, like several other European countries, it refused to have the euro as its currency.

Today, the EU consists of many countries. By 2004 its 14 countries were joined by 10 more, and three more joined in 2007. The European Economic Community was founded in 1957 by the Treaty of Rome. This became the European Union in 1993 after the Maastricht Treaty was ratified. This extended political cooperation, and provided for committed members to adopt a single currency by 1999. This created the single largest currency zone in the world after the US dollar. Euro notes and coins started circulating in 2002. However, three members, the UK, Denmark and Sweden, opted out of the euro zone.

Five institutions govern the EU:

- The European Council resolves major policy issues and sets policy directions.
- The European Commission is responsible for implementing EU law and monitoring member states to be sure they are in compliance.
- The Council of the European Union is the ultimate controlling authority.
- The European Parliament debates legislation proposed by the commission and forwarded to it by the council.

- The Court of Justice acts as the supreme appeals court for EU law.

For our purposes the most relevant aspect of the EU is the institutional framework it provides for business. Four aspects of EU policy shape greatly how international business can be done:

- **The 'single market'**: The EU has created an institutional framework that establishes many of the rules by which businesses compete. It has removed most internal trade barriers between member countries. Internal customs and passport controls have been abolished. A prime focus has been on establishing the four freedoms – free movement of people, goods, services and capital – among member countries. A common external tariff is applied to all imported goods across the customs union. The EU has attempted to harmonise – that is, create common rules, standards and regulations – on the free movement of goods and services, and has made considerable headway, but this has been a difficult and complex political process, with national or local regulations sometimes being allowed to stand if they are deemed more effective than EU stipulation. Moreover, and a bigger point for both goods and services, harmonisation represents liberalisation and threatens protectionism in local markets.
- **The free movement of people**: People from EU member states are free to work in other EU countries but there can be barriers. The EU has moved to guarantee mutual recognition of professional experience, qualifications and training across EU countries. It has also encouraged the movement of EU students and the advancement of higher education across EU countries.
- **European competition policy**: The European Commission regulates for competition issues such as over-dominant players or illegal collusion, but only in cases involving multiple countries. National authorities are the regulators where only a national market is affected. The EU commission also looks to regulate mergers and acquisitions, including foreign mergers, if they seem to represent a substantial impediment to effective competition within the EU. Note that the EU also regulates governments, for example, when 'state aid' or subsidies are being offered to subsidise companies or protect local jobs.
- **The euro as a common currency**: Having one currency, rather than several, is easier for companies and individuals. Instead of having to convert currencies, the same currency is used across the bloc, so companies will save the cost and risks of converting currencies. Having a single currency also makes it easier to compare prices across Europe. Another benefit of the euro is that it should boost the development of a highly liquid pan-European capital market. Finally, the capital market will provide a greater range of investment options to individuals and institutions. Are there disadvantages? Individual countries lose control over monetary policy. The EU is not an optimal currency area, nor an area where similarities in the underlying structure of economic activities make it feasible to adopt a single currency and use a single exchange rate as an instrument of macro-economic policy. In other words, because of differences in member economies – take Portugal and Finland, for example – they might react differently to external shocks. So, a change in the euro exchange rate that helps Finland might actually hurt Portugal.

The EU is a significant, emerging superpower – even without the UK. In 2020, it contained some 5.8 per cent of the world population. In 2017, the EU (including the United Kingdom) had generated a nominal gross domestic product (GDP) of around US$20 trillion, constituting approximately 25 per cent of global nominal GDP.

Activity

Now read Willcocks (2021a) Chapter 2, section 2.8, pp.55–58, to give you a detailed feel for these issues of doing business in and with the EU.

5.6 Regional integration examples: the Americas

5.6.1 North America: From NAFTA to USMCA

NAFTA became law in 1994. Under NAFTA, tariffs on 99 per cent of the goods traded between Mexico, Canada and the USA were abolished, and so were most of the restrictions on the cross-border flow of services. The agreement also protected intellectual property, removed most restrictions on FDI between the three countries, and allowed each country to maintain its own environmental standards. In addition, two commissions were established to intervene when environmental standards or legislation were violated involving health and safety, minimum wages or child labour.

What were the benefits of NAFTA? Its supporters argued that it would provide economic gains to all members. Mexico should benefit from more jobs as companies from Canada and the USA shift production south to take advantage of lower-cost labour. The jobs would help Mexico grow economically. Economically, Mexico looked to secure preferential treatment for 80 per cent of its exports. In the USA and Canada, consumers could benefit from the lower-priced products that come from Mexico, and companies would benefit not only from low-cost labour but also from having access to a large and more prosperous market.

How did NAFTA's critics see the agreement? NAFTA's critics worried that the loss of jobs and lower wage levels that would occur as a result of NAFTA would be detrimental to the USA and Canada. They also raised concerns that pollution would increase as companies shifted production to take advantage of Mexico's more lax environmental regulations. In addition, some critics raised concerns that Mexico would lose its sovereignty as the country became dominated by US businesses not really committed to helping the economy grow, but rather just seeing Mexico as a cheap assembly location.

After the first decade of NAFTA, most people agreed that both the critics and the supporters of the agreement were probably guilty of exaggeration. By most statistical measures NAFTA was a success with trade between the countries and FDI into Mexico growing very quickly indeed. For example, studies showed that the concern over jobs turned out to be a non-issue. Jobs in Mexico boomed while job losses in the USA were very small. Some US businesses preserved jobs because most components in Mexican assembly plants used US-made parts, unlike Asian-based assembly plants. One positive that came from the agreement was increased political stability in Mexico. This, of course, was also beneficial to the USA and Canada. Some Mexican critics pointed out that job gains stagnated as the US and Canadian multinationals shifted more work to China rather than Mexico.

But NAFTA's very recent history has been more problematic, partly because of the more aggressive negotiating stance adopted by the US administration elected in 2016. After US President Donald Trump took office in January 2017, he sought to replace NAFTA with a new agreement, beginning negotiations with Canada and Mexico.

On 27 August 2018, Mexico and the United States announced they had reached a bilateral understanding on a revamped NAFTA trade deal that included provisions that would boost automobile production in the USA The agreement favoured the USA more than Mexico. Negotiations with Canada followed. According to an August 2018 article in the *Ottawa Citizen*, key issues under debate included supply management; pharmaceuticals; cultural exemption; the sunset clause; and de minimis thresholds. In September 2018, the United States, Mexico, and Canada reached an agreement to replace NAFTA with the United States–Mexico–Canada Agreement (USMCA). NAFTA remained in force, pending the ratification of the USMCA. In January 2020, the revised agreement was signed into law in the USA. The new agreement certainly saw a move towards trade barriers and protectionism by the USA.

A range of trade experts have said that changing trade relations would have a range of unintended consequences for the USA, including reduced access to the USA's biggest export markets; a reduction in economic growth; and increased prices for gasoline, cars, fruits, and vegetables. The worst affected sectors would be textiles, agriculture and automobiles.

5.6.2 Mercusor and the Andean Community

It is useful to look at regional blocs that are less successful. Mercusor includes a population of more than 270 million, with the combined Gross Domestic Product of the full-member nations over $3.0 trillion a year ($3.393 trillion in 2018) making it the fifth-largest economy in the world. It is the fourth largest trading bloc globally.

The Andean Pact between Bolivia, Chile, Ecuador, Columbia and Peru was formed in 1969 and modelled on the EU. However, by the mid-1980s, it was clear that it had more or less failed to achieve any of its goals. In the late 1980s, though, many Latin American countries began to adopt free market policies, and in 1990 the Andean Pact was re-launched and now operates as a customs union. In 2003, the Andean Community signed an agreement with Mercusor to work towards a free trade area.

Mercusor began in 1988 as a free trade agreement between Brazil and Argentina. It was expanded to include Paraguay and Uruguay in 1990, and has been making progress towards free trade between the countries. However, some critics have argued that rather than creating trade, Mercusor, by establishing high tariffs to outside countries, is actually diverting trade in some industries and that companies in these industries will be unable to compete in global markets. In recent years, the future of this group has been shaky, not least because of politics. Venezuela pulled out of the Andean Community in protest against Colombia and Peru signing trade deals with the USA. Uruguay demanded the right to sign a separate trade deal with the USA despite being a Mercusor member. The central problem has been that members of both trade blocs actually trade very little with each other but mainly with the USA. Other economic blocs have been proposed but seem difficult to organise and sustain in the difficult political disunity of the continent. The working of Mercosur has not met with universal approval within interested countries. Chile has, to a certain extent, preferred to pursue bilateral agreements with trading partners, and there have been calls from Uruguayan politicians to follow this example.

Mercosur signed free trade agreements with Israel in December 2007; with Egypt in August 2010; with the State of Palestine in December 2011; and with Lebanon on 18 December 2014. In 2016, Brazilian presidents, Dilma Rousseff, and later Michel Temer, along with Argentine President Macri, began to exert pressure to negotiate a free trade agreement between Mercosur and the European Union and other Latin American nations. In June 2019, the European Union– Mercosur Free Trade Agreement was confirmed. The bilateral trade deal opens 100 per cent of EU trade and 90 per cent of Mercosur trade. The deal, however, took a long time to be ratified.

Activity

Read Willcocks (2021a), Chapter 2, section 2.9, pp.43–44, then answer the following questions.

1. What do you see as the advantages and disadvantages of USMCA membership to each of the three countries?
2. Why have the Andean Community and Mercusor been unsuccessful in comparison?
3. For a company in your own country, what do you see as the risks in trading with these three economic blocs?

5.7 Regional integration examples: Asia Pacific

One of the most important efforts in Asia Pacific is the Association of South East Asian Nations, or ASEAN. This was formed in 1967 with five founding nations, later increased to 10, including Brunei; Cambodia; Indonesia; Laos; Malaysia; Myanmar; The Philippines; Singapore; Thailand; and Vietnam. There are two observer nations: Papua New Guinea and Timor Leste. ASEAN's goals are to promote free trade between members and achieve cooperation on industrial policy, but so far, it has made only slow progress. However, a new agreement between the six original members came into effect in 2003 to create a free trade area, with the creation of the ASEAN Economic Community by 2015.

Across all nations of ASEAN, there is a population of over 622 million people. The region has one of the largest economies in the world, and it is believed that by 2050, it will have the fourth largest economy in the world. The organisation focuses on boosting economic and trade growth, with all member states having a free trade agreement. Travel within the region is also easier for member states. All member states have signed a treaty against the development of nuclear weapons. Most have also signed on to a counter-terrorism pact. Technical and research cooperation is also promoted across the member states.

ASEAN has suffered because members' main trading partners – USA, Japan, China, and Europe – are outside the ASEAN bloc. Size of intra-ASEAN trade also varies from country to country so benefits of membership are unevenly distributed. Furthermore, ASEAN experiences internal political tensions, and much more economic, religious, and cultural diversity than, say, the EU.

However, ASEAN does act as a group in negotiating agreements with other countries, or groups like the EU for which it is an important trading partner. As a region, ASEAN has undeniably grown in importance. Southeast Asia is quickly establishing itself as an Industry 4.0 hub. Geopolitically, it has become a valuable site of contention with major powers such as the USA and China looking to establish their influence over the region. In 2018, in response to US President Donald Trump's more insular policies, ASEAN proposed a trade agreement of its own: The Regional Comprehensive Economic Partnership (RCEP). The RCEP could be one of the biggest trade deals in history as it would encompass 25 per cent of global gross domestic product (GDP); 45 per cent of the total population; 30 per cent of global income; and 30 per cent global trade. Other countries involved in this trade agreement are India; China; Japan; South Korea; Australia; and New Zealand. But passing the agreement has been a challenge on its own. In 2018, ASEAN and the countries involved missed its fourth deadline to sign the deal, despite having negotiations for more than a year. It was reported in November 2019, however, that Southeast Asian countries were committed to signing the mega Asia Pacific trade pact in 2020. ASEAN Secretary-General Lim Jock Hoi had also said that ASEAN leaders, together with their counterparts from the five RCEP participating countries had agreed to push forward and sign the trade pact in 2020.

Activity

Read Willcocks (2021a) Chapter 2, sections 2.7 to 2.10, pp.53–63, to consolidate your understanding of this chapter and make notes on points and cases.

1. Find out more details on the operation and recent history of ASEAN by searching on the Internet.
2. If your country was a member of ASEAN in 2021, what do you see as the advantages and disadvantages of membership for your country?
3. How has the RCEP worked out?

5.8 Key concepts

The key concepts in this chapter are:

- World Trade Organization
- International Monetary Fund
- free trade area
- customs union
- common market
- economic union
- regional integration
- European Union
- NAFTA
- USMCA
- Mercusor
- Andean Community.
- ASEAN
- RCEP.

5.9 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- explain the multilateral institutions of the global trade system and their current challenges

- describe the multilateral institutions of the global monetary system and discuss their current challenges
- describe the advantages and disadvantages of regional and bilateral economic integration in Europe, the Americas and the Asia Pacific
- discuss the EU's political institutions and how and why the institutional framework created by the EU is pivotal for business
- participate in debates about further multilateral policy forums and institutions contributing to economic integration
- outline the implications for management action.

5.10 Test your knowledge and understanding

Look at the Video – 'Economic integration between countries':

- www.youtube.com/watch?v=4HjN1FPYXaY

1. Focus on the EU and make notes on how it operates.
2. Focus on your own economic bloc and make notes on what it is and what it does.

5.11 Sample examination question

'Regional integration has been an imperfect, but valuable way of protecting trade amongst member countries, but creates challenges for international businesses'. Discuss this statement under the following headings:

a. Describe the major types of regional integration, giving an example of each.
b. What are the political and economic arguments in favour of, and against regional integration? Give examples from existing blocs, (e.g. ASEAN, NAFTA/USMCA, EU) to illustrate your points.
c. Using illustrative examples, evaluate the challenges and opportunities regional integration presents to an international business?

Notes

Chapter 6: Exchange rates and the international monetary system

6.1 Introduction

An international business has to deal in many currencies. The amount of money being exchanged every day globally is massive, and this creates a high degree of dynamism, and volatility in currency exchange rates. This creates risks for international businesses that deal in more than one currency, risks that rise with each currency added. These risks have to be mitigated, and understanding how the market works is a first important step. How are these currencies valued against one another, what determines these valuations and how can managers deal with currency fluctuations? In what follows we look at the workings of foreign exchange markets, and the major factors that determine the value of a currency. We investigate the implications for managers, and how they can protect their firms against different types of exchange rate risk. We also deal with the institutions that comprise the international monetary system, including two we have met in earlier chapters – the International Monetary Fund and the World Bank. We will review the different exchange rate policies available to countries, which policies are adopted, and why. We also assess how international firms can respond to these features of the global financial system.

6.1.1 Aims of the chapter

The aims of this chapter are to:

- explain the factors that determine exchange rates that impact on the conduct of international business
- provide a history of the international monetary system and identify its role, importance and challenges
- describe the International Monetary Fund (IMF) and its roles and performance
- explain how a firm and its management can respond to exchange rate risks in international business.

6.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- describe the determinants of exchange rates
- outline the development of the international monetary system
- discuss the role of the International Monetary Fund
- identify the company's possible management responses to dealing with currency exchange rate risks.

6.1.3 Essential reading

Willcocks, L. *Global business: management.* (Stratford-upon-Avon: SB Publishing, UK, 2021b) Chapter 6, pp.142–57.

6.1.4 Synopsis of chapter content

International markets for currencies; issue around exchange rates; managerial impacts of exchange rate changes; assessing the international monetary system and its institutions; implications for managers; managing exchange risk.

6.2 Markets for currencies

The foreign exchange market is simply a market for converting the currency of one country into that of another country. An exchange rate is the rate at which one currency is converted into another. The foreign exchange market is also used to provide some insurance against foreign exchange risk, or the adverse consequences of unpredictable changes in exchange rates. For example, just the announcement, in November 2020, of a vaccine potentially 90 per cent effective against COVID-19 led to considerable fluctuations in exchange rates and share prices worldwide. International companies use the foreign exchange markets for several main reasons:

- to convert the foreign exchange payments they receive for exports, or the income they receive from foreign investments or from licensing agreements with foreign companies in foreign currencies
- when they need foreign exchange to pay a foreign company for products or services
- for short-term money market investments
- to engage in currency speculation where funds are moved from one currency to another in the hopes of making a profit using the foreign exchange markets.

Companies are also active in the foreign exchange market to insure against foreign exchange risk, which occurs when unpredicted changes in future exchange rates have adverse consequences for the company. The term **hedging** is used to describe this process. A forward exchange occurs when two parties agree to exchange currency and execute the deal at some specific date in the future using a forward exchange rate. In contrast, a spot exchange rate is the rate at which a foreign exchange dealer converts one currency into another currency on a particular day. Hedging against adverse exchange rate movements is an important part of an international company's financial strategy.

Where is the foreign exchange market located? It is actually not located in any single place; rather it is a global network of banks, brokers and foreign exchange dealers connected by electronic communications systems. The most important centres are London, New York, Tokyo and Singapore. In addition, thanks to high-speed computer links between trading centres around the world, there is now a single market for currencies. If there were significant differences between markets, dealers could take advantage of arbitrage opportunities where they buy the currency at a low price in one market, and sell it for a high price in another market. Another feature of the foreign exchange market is that, still into the third decade of the 21st century, the US dollar is used as a vehicle currency to facilitate the exchange of other currencies. Will this change? It is difficult to predict. For example, what role will the Chinese currency play during the 2020s – surely a much more powerful one? What happens if/when cryptocurrencies and blockchain gain a big role globally in currency exchange and commercial transactions?

Exchange rates are determined by supply and demand, but what affects the supply and demand for a currency? Willcocks (2021b) Chapter 6 suggests:

- **Relative price differences**.
- **Inflation and money supply**.
- **Interest rates**: Variations in bank interest rates can affect investor behaviour powerfully. The bank rate in a country is established by its central bank. The bank rate influences the rates other banks charge for customers to borrow money, or how much they are paid for savings. The current (spot) exchange rate will be influenced by the interest rates offered on investments in both countries (e.g. on government bonds). But forward exchange rates – the price of a currency 30, 60, 90 or 120 days in the future – are also influenced by market participants' expectations about the interest rates then prevailing.
- **Productivity and balance of payments**: A rise in a country's productivity improves its competitive position and tends to lead to a rise in the demand for, and value of, its currency. A country experiencing a current account surplus will see its currency appreciate in value, while a country experiencing a current account deficit will see its currency depreciate.
- **Investor psychology**: The theories we have talked about tend to deal with long-term movements of exchange rates. But short-term movements are also influenced by investor psychology. The **bandwagon effect –** investors moving as a herd in the same direction at the same time – can occur when expectations by traders turn into self-fulfilling prophecies, and traders join the bandwagon and exchange rates move on group expectations. Sometimes, intervention by the government can stop a bandwagon effect from starting, but not always.

Activity

Read Willcocks (2021b) Chapter 6, pp.142–47.

1. Make a list of the factors that influence the setting of exchange rates.
2. Make a preliminary list of what actions you think an international business manager can take to deal with these factors and protect the company against exchange rate risks.

6.3 Implications for managers

It is essential that managers understand the influence of exchange rates on the profitability of trade and investment deals because an adverse shift in the value of a currency can turn a deal that had appeared to be profitable into a bad choice. Companies need to protect themselves against three types of foreign exchange risk:

- **Transaction exposure** is the extent to which the income from individual transactions is affected by fluctuations in foreign exchange values.
- **Translation exposure** is the impact of currency exchange rate changes on the reported financial statements of a company.
- **Economic exposure** is the extent to which a firm's future international earning power is affected by changes in exchange rates.

How can companies minimise their translation and transaction exposure? They can use a strategy of leading and lagging payables and receivables where they pay suppliers or collect payments early or late depending on anticipated exchanged rate movements.

Reducing economic exposure is a little more difficult. It requires the company to distribute productive assets to various locations so that the company's financial wellbeing is not severely affected by changing exchange rates. Reducing economic exposure also requires companies to be sure that assets are not concentrated in countries where likely rises in currency values will mean significant increases in the prices of the goods and services produced. Companies can also reduce their foreign exchange risk by:

- implementing a system of centralised control to protect resources efficiently and ensure that each sub-unit adopts the correct mix of tactics and strategies forecasting future exchange rates
- establishing good reporting systems so the central finance function can regularly monitor the company's exposure position
- producing monthly foreign exchange exposure reports that can be used as the basis for hedging strategies
- Risk avoidance, for example avoiding foreign currency transactions as much as possible, using different currencies to avoid overdependence and exposure, transfer the risk to an insurer or guarantor
- 'hedging' to protect against future adverse exchange rate movements.

Activity

Look at the list of management actions you made in the previous Activity and add new details to it in the light of this section. Read Willcocks (2021b) pp.147–48 to help you here.

6.4 Institutions of the international monetary system

In practice, currency markets are not free floating but are heavily influenced by governments and international institutions. You need to understand these influences and how business managers can deal with them.

The international monetary system refers to the institutional arrangements that countries adopt to govern exchange rates. A **floating** exchange rate system exists when the foreign exchange rate market, or supply and demand, determines the relative values of currencies. This is the type of system used in the USA, the European Union, Japan and the UK. When the value of a currency is determined by market forces, but the central bank intervenes if it depreciates too rapidly against an important reference currency, a 'dirty float' exists. China has used this type of system since 2005. The yuan is allowed to float against a basket of currencies that include the dollar, the euro and the yen, but only within very tight limits. Countries that adopt a **fixed** exchange rate system fix the values of their currencies against each other. Prior to the introduction of the euro, some EU countries operated under fixed exchange rates within the context of the European Monetary System. A **pegged** exchange rate system exists when the value of a currency is fixed to a reference country and the exchange rate between that currency and other currencies is determined by the reference currency exchange rate.

The present international monetary system grew out of the two previous arrangements. The first was the **gold standard** period from roughly 1870, under which each currency was linked to a fixed amount of gold. The US dollar, for example, was equal to 23.22 grains of fine gold. The exchange rate between currencies then was based on the gold par value, or the amount of a currency needed to purchase one ounce of gold. By the start of the Second World War in 1939, the gold standard had been abandoned. Under the **Bretton Woods system** (1944–73) the only currency that was to be convertible to gold was the US dollar. Other countries set their exchange rates relative to the dollar. As part of the Bretton Woods agreement, the International Monetary Fund (IMF) was designed to maintain order in the international monetary system and the World Bank was created to promote general economic development.

The IMF, using a combination of flexibility and discipline, was responsible for executing the main objectives of the Bretton Woods agreement, with the goal of avoiding the chaos that occurred during the time between the wars. The fixed exchange rate system provides discipline in two ways. First, the need to maintain a fixed exchange rate limits competitive devaluations and brings stability to the world trade environment. Second, because the system imposes monetary discipline on countries, inflation is limited. The IMF created a fund using contributions from members that gave it the ability to lend foreign currencies to members to tide them over during short-term balance of payments deficits when implementing a rapid tightening of monetary or fiscal policy would harm the domestic employment situation.

The **World Bank** was initially designed to lend money to help rebuild Europe, but shifted its role to helping developing nations. The Bretton Woods system worked well until the late 1960s when it began to collapse due to US inflationary policies and rising productivity elsewhere, leading to a deterioration of the USA's foreign trade position and pressure on the value of the US dollar. The Bretton Woods system was only viable when the US inflation rate was low and if the USA did not run a balance of payments deficit, and so it collapsed and currencies began to float against each other.

6.4.1 The post-Bretton Woods system: 1973 to the present

Since 1973, exchange rates have become more volatile and less predictable for several reasons, including:

- the 1971 oil crisis
- the loss of confidence in the US dollar that came after US inflation rate spiked in 1977–78
- the 1979 oil crisis that doubled the price of oil
- the unanticipated rise in the dollar between 1980 and 1985
- the partial collapse of the European Monetary System in 1992, and
- the 1997 Asian currency crisis that saw various Asian currencies lose between 50 and 80 per cent of their value.

More recently, the 2008–09 financial crisis had an impact globally, still felt into the 2020s; while moves towards protectionism have thrown additional factors into play in the currency markets. The 2020–21 crisis led to serious rethinking of the global and financial systems in which international businesses have to operate.

Since 1973 countries have tended to choose between four major exchange rate policies:

- **Floating exchange rate policy**: This policy allows demand and supply conditions to determine exchange rates. A free float is a pure market solution, but more typical is a managed float whereby exchange rates are influenced by selective government intervention.

- **Pegged exchange rate policy**: This attaches the country's exchange rate to that of another country's currency. For example, the Danish krone is pegged to the euro. This limits fluctuations within a narrow band relative to the other currency. The 'pegged' policy seeks to stabilise import and export prices, which is especially important for smaller countries. Also many developing countries with high inflation see advantages in pegging their currencies with, say, the US dollar or euro, which traditionally have low inflation.
- **Fixed rate policy**: Because of the volatile nature of the floating exchange rate system, there has been renewed interest in a fixed exchange system in recent years. Supporters of fixed exchange rates argue that the monetary discipline required by a fixed exchange rate system ensures that governments will not expand their money supplies at inflationary rates. This also avoids large currency fluctuations arising from market speculation. For companies, uncertainty from a floating exchange rate system makes planning more challenging than it would be under a predictable fixed exchange rate system. The most extreme fixed rate policy is a **currency board,** which is a monetary authority that issues notes and coins convertible into a key foreign currency at a fixed exchange rate, usually fixed by law. When a country adopts a currency board it commits to converting its domestic currency on demand into another currency at a fixed exchange rate. Hong Kong was successful with this type of arrangement during the Asian crisis in 1997, backing the domestic currency with 100 per cent of equivalent foreign currencies. In 2011, Hong Kong's currency board ensured every HK$7.8 in circulation was backed by US$1.
- **Common currency policy**. Here a country gives up its monetary policy and relies on another country or common central bank to manage inflation and exchange rate. For example, 14 West African countries use the CFA franc which is in fact fixed to the euro. The euro itself is, of course, a common currency shared, in 2021, by 19 EU member, and six non-EU European countries and controlled by the European Central Bank in Frankfurt.

6.4.2 Crises and the role of the IMF

International business managers are affected greatly by financial crises. A currency crisis occurs when a speculative attack on the exchange value of a currency results in a sharp depreciation in the currency, or forces the government to expend large amounts of international currency reserves and sharply increase interest rates in an effort to maintain the prevailing exchange rate. A banking crisis refers to a situation in which a loss of confidence in the banking system leads to a run on the banks when everyone withdraws their deposits. A foreign debt crisis is a situation in which a country can no longer service its foreign debt obligations. Sometimes these crises occur simultaneously as they did in the 1997 Asian crisis and the 2000–02 Argentinian crisis. IMF data show that developing countries are far more likely to experience a currency crisis than developed countries. Two recent crises in which the IMF was heavily involved were the 1995 crisis in Mexico and the Southeast Asian financial crisis in 1997.

How well has the IMF done? Its role in these two crises and the more recent 2008–12 crisis has been much debated and we cannot cover this in detail here. In 2008, it was committed to helping 65 countries. All of its packages came with conditions that typically involved tight macroeconomic policy and tight monetary policy. However, not everyone thinks this is the right policy. The IMF has been criticised for having a one-size-fits-all approach to macroeconomic policy. Critics argue that what might be right for one country is not necessarily best for another country. For example, many critics felt that applying the same policies in Asia, where there was significant private sector debt, as were used for countries with excessive government spending, was not appropriate.

Critics have also complained that the IMF has been exacerbating moral hazard, which occurs when people behave recklessly because they know they'll be saved if things go wrong. In other words, because the IMF provides a safety net, countries may not always make the best decisions for their economies. For example, banks in Japan were willing to extend loans to overextended Asian companies during the 1990s when they probably should not have. Finally, there is concern that the IMF has too much power, and too little accountability. But keep in mind that while the IMF has its detractors, it also has its supporters. And, as Willcocks (2021b) indicates, the IMF remained very active during the 2020–21 crisis. The election of Joe Biden as US president in late 2020 also gave the IMF a chance to reset its relationship with its largest shareholder and make green initiatives a bigger part of its global economic recovery plan.

Activity

Read Willcocks (2021b) Chapter 6, pp.149–52, then answer the following questions:

1. Make a list of the advantages and disadvantages of a) floating exchange rates, b) pegged and fixed rate exchange rates.
2. Why would countries like Hong Kong and Argentina adopt the currency board option?
3. Assess the role of the IMF in recent years. How does the IMF help or disadvantage a company undertaking international business?

6.5 Managing exchange risks – implications for managers

Inevitably, internationally operating companies are exposed to exchange rate movements. The 2020–21 crisis was an extreme expression of this reality. They face risks of financial losses because of unexpected changes in exchange rates. The fundamental way of reducing exchange rate risk is to ensure that future revenue streams and future expenses are in the same currency. One way to achieve this is to invoice in your own currency. But this is not always possible. More frequently, financial flows are in different currencies leading to further risks that need to be managed. Companies can use two ways to manage these risks:

- **Strategic hedging**: This involves organising activities in such a way that the currencies of revenues and expenses match. For example, in 1998 Toyota set up its new factory in France rather than expand its UK operation. The reason? It was expanding sales into the European Union whose currency was the euro, while the UK's currency was in pounds sterling. Part of the production costs occurred locally, in France, and so were in euros, thus reducing exchange rate exposure. Strategic hedging involves big foreign direct investment and sourcing decisions that we discuss in more detail in Chapters 4 and 12 of this guide.
- **Risk diversification**: This involves reducing risk exposure by working with a number of different currencies. A company can then offset losses in some regions and currencies by gains in other regions and currencies.

These, however, are only partial responses to the problem of currency risk. An additional response is to use financial markets to offset currency risk.

Two approaches are frequently used:

- **Currency hedging**: This involves undertaking transactions that protect the trader and investor from exposure to the fluctuations of the currency spot rate. However, there are no guarantees because essentially you are betting on the current exchange rate and possible fluctuations in future exchange rates, and making decisions that you think will be optimal.
- **Currency swap**: This is a currency exchange transaction between two companies in which one currency is converted into another in Time 1, with an agreement to revert it back to the original currency at a specific Time 2 in the future. The primary participants of the currency exchange market are large international banks that trade among themselves. They make money by trading money. They do this by capturing the difference between the offer rate (the price to sell) and bid rate (the price to buy), with the difference (or profit) between the 'sell high, buy low' approach being called the 'spread'. Modern electronic trading enables very fast huge volume buying and selling decisions that can make enormous profits on thin spread transactions.

For managers, understanding the international monetary system is important for currency management, business strategy and corporate–government relations. Some implications for managers are:

- Companies must realise that the foreign exchange system that is currently in place is a mixed system where government intervention and speculation can influence exchange rates.
- Speculative buying and selling of currencies can create a volatile situation that companies need to protect themselves against.
- While individual transactions can be hedged through the forward market, companies need to maintain strategic flexibility to protect against economic exposure. In 2007, for example, many companies faced the challenge of dealing with a weak US dollar. Some foreign suppliers decided that, rather than risk trying to pass the effects of the declining dollar on to consumers in the form of higher prices, they would simply accept a smaller profit margin instead.
- Companies need to keep in mind that they can influence a government's policy towards the international monetary system. Exporters in the USA, for example, have sometimes lobbied for devaluations in the dollar to make exports more attractive in foreign markets. Recall that the US government, under Donald Trump, from 2016–21 was particularly responsive to corporates and their international trade issues, and especially concerned with what was perceived as the undervaluing of the Chinese yuan by China their main global rival, but also a major mutual trade partner.

Activity

Read Willcocks (2021b) section 6.5, pp.153–56. Ask yourself:

1. What are the major ways a company has of managing the currency risks incurred through operating internationally?
2. Does adopting a crypto-currency avoid the risks?

6.6 Key concepts

The key concepts in this chapter are:

- foreign exchange market
- currency exchange rate
- hedging and strategic hedging
- purchasing power parity
- balance of payments
- investor psychology
- international monetary system
- International Monetary Fund
- World Bank
- floating, pegged and fixed exchange rates
- currency swap.

6.7 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- describe the determinants of exchange rates
- outline the development of the international monetary system
- discuss the role of the International Monetary Fund
- identify the company's possible management responses to dealing with currency exchange rate risks.

6.8 Test your knowledge and understanding

Should China revalue the yuan against the dollar? To what? If it does as you suggest, what impact do you think this will have on the following?

a. US balance of payments
b. Chinese balance of payments
c. the relative competitiveness of Mexico, Thailand and your own country
d. European companies importing from China
e. European retail consumers.

Look at the VLE case study Chapter 6: 'China and the fluctuating Yuan', and then answer the following questions:

1. Why did the Chinese yuan depreciate against the US dollar between August 2015 and December 2016? What were the benefits and costs for China?
2. Why did the Chinese government try to limit this depreciation? Why did this not stop the fall in the yuan?
3. Why did conditions reverse in 2017, with the yuan appreciating against the US dollar? What does this tell you about how exchange rate markets work?
4. What could a Chinese importer of Scottish whisky have done to limit the negative impact of the yuan depreciating against the US dollar in 2016?
5. As a Chinese exporter of toys, who anticipated that the yuan would gain value against the US dollar during 2017, what action would you take?

6.9 Sample examination question

'Exchange rate management has to be a major financial technique many international firms which are engaged in cross-border trade and investment activities.'

Therefore:

1. Explain the determinants of a currency's exchange rate.
2. Describe, with examples, the three types of exchange rate exposure that international firms face.
3. How can an international business reduce its exposure to exchange rate risks?
4. What are the disadvantages of the risk strategies you identified in question 3 above?

Part 3: International business strategy

Notes

Chapter 7: Overview of strategy and the enterprise in international contexts

7.1 Introduction

This chapter provides an introduction to international business strategy. In order to go international, all companies must first develop a strategy and identify how to create more value by operating in foreign as well as domestic markets. An important part of strategy is to design the company's value chain of primary and support activities to ensure the company has the processes and activities necessary to create and optimise value. The managers of a firm must also understand the economics of international enterprise and, in particular how they can achieve economies of location, scale and, from experience, effects.

With this in place, the company needs to carry out an environmental analysis to identify the key factors that can support or constrict strategic action in different markets. We provide four frameworks – PESTEL, MiniMax, CAGE and SWOT – to facilitate such an analysis.

Finally, the company needs to choose a strategy. We introduce four types of strategy commonly pursued in international business, look at how such strategies evolve, and detail Ghemawat's aggregation, arbitrage and adaptation (AAA) strategy triangle as a basis for designing strategy for international contexts.

You may think that in today's unpredictable, uncertain and dynamic business environment, as underlined by the 2020–21 COVID-19 crisis, strategy as long-term planning has become more or less valueless. In practice, it has become more necessary. However, it must be more adaptive, based on a variety of scenarios, and reliant on operational resilience able to deliver on different plans, and responsive to changes in strategic direction. Part 4 of this guide covers operations. In this chapter we begin Part 3 on International Business Strategy by introducing how businesses can behave strategically in international contexts.

7.1.1 Aims of the chapter

The aims of this chapter are to:

- introduce the nature of strategy, value, how it is created, and the value chain of a firm
- establish the major economies firms try to gain internationally from location, experience curve effects and scale
- identify the major frameworks for conducting an environmental analysis, including PESTEL, Minimax, CAGE and SWOT
- demonstrate how Ghemawat's AAA model can be used to develop an international business strategy for a firm
- establish four basic international strategies – international, localisation, global standardisation and transnational – and how firms can evolve and grow through adopting these strategies at different times.

7.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define the concepts of strategy, value creation and the value chain of a company
- apply these concepts to real-life cases in international business
- identify economies from location, experience effects and scale, and apply these ideas to strategy development in international business
- describe the major components of an environmental analysis and apply the PESTEL, SWOT, Minimax and CAGE frameworks to actual cases
- explain how to develop international business strategy for an organisation using Ghemawat's AAA model and choosing a developmental path across the four basic international strategy types, namely international (home replication), localisation, global standardisation and transnational strategies.

7.1.3 Essential reading

Ghemawat, P., 'Managing differences: the central challenge of global strategy', *Harvard Business Review* 85(3) 2007 pp.42–55.

Ghemawat, P., 'Distance still matters: the hard reality of global expansion', *Harvard Business Review* 79(11) 2001 pp.137–47.

Porter, M., 'What is strategy?', *Harvard Business Review* 74(6) 1996 pp.61–78.

Willcocks, L. *Global business: strategy in context.* (Stratford-upon-Avon: SB Publishing, 2021a) Chapter 4.

7.1.4 Further reading

Ghemawat, P. 'Developing a global strategy' in *Strategy and the business landscape*. (London: Pearson, 2008) third international edition.

Ghemawat, P. 'Regional strategies for global leadership', *Harvard Business Review* 83(12) 2005 pp.98–108.

Peng, M. and E. Pleggenkuhle-Miles 'Current debates in global strategy', *International Journal of Management Reviews* 11(1) 2009, pp.51–68.

Rugman, A. and R. Hodgetts 'The end of global strategy', *European Management Journal* 19 2001, pp.333–343.

Yin, E. and Choi, C., 'The globalisation myth', *Management International Research* 45 2005, pp.103–20.

7.1.5 References cited

Chandler, A. *Strategy and structure*. (Boston: MIT Press, 1962) p.13.

Friedman, T. *The world is flat: the globalised world in the twenty-first century*. (New York: Penguin, 2007).

Ghemawat, P. *Laws of globalisation and business applications*. (Cambridge: CUP, 2018).

Hitt, M.D., D. Ireland and R. Hoskisson *Strategic management*. (Mason OH: Thomson South-Western, 2003) fifth edition, p.9.

Oster, S. *Modern competitive analysis*. (New York: Oxford University Press, 1999) third edition, p.4.

7.1.6 Synopsis of chapter content

What is strategy?; how value is created by the firm; three sources of economies, namely location, experience curve and scale; international environmental analysis, Ghemawat's adaptation, arbitrage and aggregation framework; how to choose an international business strategy.

7.2 Strategy and value creation

A company's strategy has been defined variously as a long-term plan, a set of actions and/or as an integrated set of commitments. For example:

> The determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.
>
> (Chandler, 1962, p.13)
>
> An integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage.
>
> (Hitt, Ireland and Hoskisson, 2003, p.9)

Here we will work with the Hitt et al.'s (2003) definition, recognising that strategy looks at long-term (three years or more) direction, while planning actions for short- (one-year) and medium-term (three-year) goals. Strategy asks, and seeks to answer, three fundamental questions:

- Where are we now?
- Where do we want to be/must we be?
- How do we get there?

These questions form the essence of strategy. The essence of strategy is shown in Willcocks (2021a) Chapter 4, p.105, figure 4.1. Please look at this figure now. You can apply the framework to identify, analyse and make strategy recommendations for any organisation. Note that in figure 4.1 not all espoused strategies work, and some planned aspects may be modified or dropped (unrealised strategy). On the other hand, not all strategies that eventually get enacted appear in the original plan. They may emerge in the course of events, as managers respond to circumstances, take opportunities or have to react to unexpected events (emergent strategy).

Activity

Test the usefulness of Willcocks (2021a) figure 4.1 now. Take a large company you know well (e.g. Singtel in Singapore, Barclays Bank in UK or Tata in India). Apply the framework to the period 2015–21. Strategically, where was the company in 2015? Where did it want to get to? What strategy did it follow to get there? Go online and use the company's 2015 and latest annual reports to help you with this task.

7.2.1 Value creation and the value chain

A business needs to pursue strategies that increase profitability and profit growth. Profitability is the rate of return the company makes on its invested capital. Profit growth is the percentage increase in net profits over time. In general, higher profitability and profit growth increases the value of a company to its owners or shareholders. A company can increase profitability by adopting strategies that a) reduce costs, and/or b) add value to the company's products/services, thus allowing it to raise prices. A company can increase the rate of profit growth by selling more products/services in existing markets, or pursue strategies to enter new markets. Generally speaking, companies expand internationally because they experience restrictions and competition in their domestic markets, and see international business as a way of increasing profitability and their profit growth rates.

In practice, a company is always trying to find the optimal, that is the most profitable, balance between

1. keeping its own costs low and
2. differentiating its products/services in ways that allow it to increase prices to levels at which enough customers will still buy those offerings.

The trick is to identify the market segment – that is, the group of customers – to whom your product/service and price are more attractive than those offered by the competition.

This is not easy. Take North American hotel chains that operate internationally. The Four Seasons positions itself as a luxury chain and stresses the high value of its product offering. It can thus charge a premium price for its differentiated product, but at the same time will incur increased costs of operation (e.g. more service staff per customer, better quality of food and restaurant). The Marriott, Sheraton and Westin chains aim to offer sufficient value to attract international business travellers but do not compete in the luxury market, though they do compete against each other. Profitability can be enhanced by cutting costs, but will this affect the quality of the product/service and therefore the customer experience? Will this then drive customers to rival hotels? Improving the product/service and customer experience could attract customers, allowing price increases, but at what point do higher prices drive customers elsewhere? And what are the adverse cost impacts of improving quality? We will revisit these issues in the next chapter when discussing Porter and cost versus differentiation strategies.

Activity

Gain a preliminary insight here into competitive strategy and how companies compete on cost and differentiation by reading Porter (1996). The topic will be covered in detail in Chapter 8.

7.2.2 The firm as a value chain

The international hotel chains mentioned above, like all businesses, will only create superior value if they organise their operations efficiently.

Operations here are defined as the different value creation activities a company undertakes. These include, in a manufacturing business, for example, production, marketing and sales, research and development (R&D), human resources, information systems, logistics and infrastructure. See Willcocks (2021a) p.106, figure 4.2 for an example. You will see that the value chain consists of primary activities and support activities. For example, a service organisation like Singapore Airlines will have its primary activities organised around producing its services – selling the right plane seat, providing responsive service to or at the airport, during and after the flight.

Primary activities have to do with the design, production and delivery of the product/service, its marketing, and its support and after-sales service (see Chapter 10 for more discussion of marketing and R&D). All create value in various ways:

- **R&D** adds value through the design of products, services and production processes (e.g. banks compete by designing new financial products like mortgages, insurance policies and processes such as online banking, smart money cards, etc.)
- **Production** adds value to a product by converting raw materials into an item (e.g. a car, a computer). In a service like health care, 'production' consists of delivering the service (e.g. a heart operation, a prescription).
- **Marketing and sales** can increase the perceived value of a product/service through global branding ('your promise to the customer') and advertising, (e.g. Gillette differentiating its razors from non-branded razors or more local products).

- **Customer service** can give support throughout the whole of a customer's buying experience from awareness of the product/service through to the actual buying event to after-sales support. As one example, US-based company Caterpillar manufactures heavy earth moving machines and vehicles and can get spare parts to a customer anywhere in the world within 24 hours after a malfunction.

The support activities of the value chain provide inputs that allow the primary activities to occur. Typical support activities we deal with in later chapters are:

- logistics (sourcing and supply chain management – see Chapter 12)
- information systems management (see Chapter 13)
- human resource management (see Chapter 14).

Do not be misled. These support activities can be as important as, and sometimes even more important than, 'primary' activities. For example, Amazon began making worldwide sales through being an internet 'pure play' in the 1990s, and with no retail outlets it dominates the book market and has been able to move into other business lines: CDs, electrical goods, etc. Its IT infrastructure capability has allowed it to develop a 'cloud' (internet) based business renting digital storage space to other businesses worldwide. A major consultancy company like Accenture is crucially dependent on its HR capability for getting the best, skilled and motivated employees in sufficient numbers to service clients' needs.

Logistics deals with sourcing decisions and, in a semi-conductor manufacturer based in Taiwan, for example, the transference of physical material through the value chain from procurement through production into distribution. Efficient logistics creates value by lowering costs. When logistics is computerised, the cost reductions can be dramatic. But better still, excellent logistics can provide raw materials, components and finished goods to where they are needed faster, reducing bottlenecks in internal operations, improving end service, and even creating a point of competitive differentiation by 'delighting' the customer. The company's infrastructure provides the support for all these other activities, and includes finance and accounting, organisation structure and control systems (see Chapter 11), and IT infrastructure services (see Chapter 13).

To show the relevance of value chain analysis in the age of the internet, Willcocks (2021a) p.108, figure 4.3 portrays the value chain of an internet start-up company looking to compete against Amazon. Note that it is a service rather than a manufacturing firm, and that, like most organisations with international or even global ambitions, it is highly dependent on information and communications technologies throughout the value chain.

Activity

Read Willcocks (2021a) Chapter 4, sections 4.1 and 4.2, pp.103–09.

Think of a business you would like to set up online, selling goods or services to international and domestic markets. Draw up a starting strategy and use the value chain approach to plan your activities and how they interrelate.

7.3 Going international: gaining economies from location, experience effects and scale

The success of companies that expand internationally depends, firstly, on the goods or services they sell – that is, the competitiveness of their value proposition or offering to international customers. In Chapter 8 we shall see that this can be enhanced by carrying out **competitive positioning analysis**. But secondly, international success depends on core competencies: skills within the company that competitors cannot easily match or imitate. Core competencies enable the company to reduce the costs of value creation and/or to create perceived value so that premium pricing is possible. In the next chapter we shall see the importance of taking a **resource-based approach** to competitiveness. In addition, in domestic and international business, three ways of achieving cost advantage regularly come up in management thinking.

- **Economies of scale** refer to the reductions in unit cost achieved by producing a large volume of a product. Sources of economies of scale include: spreading fixed development and production costs over a larger volume of output; utilising production facilities more intensively; and increasing bargaining power with suppliers. Going international can help economies of scale in several ways. For example, the highly competitive global automobile industry faces intensive cost pressures in every product type, from luxury cars to the cheapest. An efficient factory needs to scale at, perhaps, 200,000 units per year. The only way to sell cars in that number is to serve international as well as domestic markets, using factory assets more intensively. Growth in output and size, fuelled by international sales, may also provide another scale benefit.
- **Location economies**: Value creation activities are dispersed to locations where they can be performed most efficiently and effectively. A location might be more attractive cost-wise because of favourable political, legal and economic factors, for example. Also, due to differences in factor costs, certain countries have comparative advantage when producing certain products, for example, historically, pharmaceuticals in Switzerland, semiconductors in South Korea and computer software in the USA. This was one reason why initially many firms moved their IT work to Indian centres like Bangalore and Mumbai, though relative labour costs there have been rising in recent years. By achieving location economies, companies can lower the costs of value creation and achieve a low-cost position, and can also differentiate their product offering. Companies that take advantage of location economies in different parts of the world create a global web of value creation activities.
- **Experience curve effects**: This refers to systematic reductions in production costs over product lifetime. Studies have tended to show, for example in the airframe industry, that whenever output doubles the cost per unit declines to 80 per cent of the previous cost. This comes mainly from learning effects, as people learn to work more productively and management achieve efficiencies in how work is organised. Where learning falls off after a few years, then economies of scale – whereby increasing the scale of production spreads costs more thinly over each unit produced – will also contribute to this cumulative effect.

Using any of these three sources of economies can have significant strategic impacts for a company. Once a company establishes a profitable low-cost position, in certain industries that can form a real barrier to new competitors.

Activity

Read Willcocks (2021a) Chapter 4, section 4.3, pp.109–11, and the 'Strategy at Proctor and Gamble' case study (VLE Chapter 7).

1. Identify the role of location and scale economies and experience effects in how Proctor and Gamble's strategy needed to evolve from 1990 to 2008. You can find additional information on Proctor and Gamble online if you need to check further details and what happened next. Look for recent videos on Proctor and Gamble as part of your search. Check out also their most recent annual reports.
2. Look at Willcocks (2021a) pp.110 and 111. Make notes on the examples of Lenovo and Matsushita and how they achieved global economies.

7.4 Analysing the international environment

So far you have gained an understanding of strategy, and the economics and activities that underpin any strategy. We now focus more specifically on how companies can move into internationalising their businesses.

There are four very helpful frameworks for diagnosing the environmental and national and international factors likely to have a high impact on the success or failure of a company's strategy.

7.4.1 The PESTEL framework

Recall Chapters 2 and 3. The PESTEL framework categorises environmental influences.

PESTEL provides a comprehensive list of influences on the possible success or failure of particular strategies. PESTEL summarises for international management purposes, that is from the company's perspective, the critical factors discussed in Chapters 2 and 3:

- **political factors**: for example, government policies, taxation changes, foreign trade regulations, political risk in foreign markets, changes in trade blocs (e.g. the EU in 2020)
- **economic factors**: for example, business cycles, interest rates, personal disposable income, exchange rates, unemployment rates, gross domestic product (GDP) trends
- **socio-cultural factors**: for example, population changes, income distribution, lifestyle changes, consumerism, changes in culture and fashion
- **technological factors**: for example, new discoveries and technology developments, ICT innovations, rates of obsolescence, increased spending on R&D
- **environmental ('green') factors**: for example, environmental protection regulations, energy consumption, global warming, waste disposal and recycling
- **legal factors**: for example, competition laws, health and safety laws, employment laws, licensing laws, intellectual property rights laws.

Here are some rules for using PESTEL:

- Apply selectively: identify specific factors that impact on the industry, market and organisation in question.
- Identify factors that are important currently but also consider which will become more important in the next few years.
- Use data to support your points and analyse trends using up-to-date information.
- Identify opportunities and threats.

7.4.2 The SWOT framework

Now is also a good time to carry out a preliminary SWOT analysis:

- S strengths of the company
- W weaknesses of the company
- O opportunities for the company
- T threats to the company.

Here S and W refer to the internal company's capabilities, while O and T refer to the PESTEL environment, plus competitive rivalry at industry level (note: we will discuss competitive rivalry in Chapter 8).

7.4.3 Minimax analysis

There is an easy way of performing a SWOT analysis and deriving some provisional views of strategy. It is called a 'Minimax' analysis. Refer now to Willcocks (2021a) p.113, figure 4.4. This shows a Minimax framework for analysing the business and creating strategies.

Ask yourself four questions:

- How can a company maximise its strengths to take advantage of its opportunities?
- How can a company leverage its strengths to minimise threats?
- How can a company maximise opportunities to minimise its weaknesses?
- What actions does a company need to take to minimise its weaknesses and threats?

Activity

Now read Willcocks (2021a) Chapter 4, sections 4.3 and 4.4, pp.109–17. Make notes on the details and examples. Note figure 4.4 in particular.

Here is a PESTEL analysis for the global airline industry as at 2015:

P government support for national carriers; increased security control; restrictions on migration

E fluctuating/declining national economic growth rates 2011–15; rising fuel prices but unstable

S rise in travel by elderly; increased student travel/exchange students

T fuel-efficient airframes/engines, bigger planes; business teleconferencing increase

E noise pollution controls increase; also controls/taxes on energy consumption; more land for airports

L restrictions on airline mergers; preferential airport rights for some carriers.

This list is not exhaustive. Pick your national airline and ask yourself:

1. How had the situation changed by the end of 2021?
2. Which are going to be the key factors that your national airline needs to see as opportunities and threats over the next five years?
3. Apply a SWOT analysis to your national airline and generate some strategic actions it can take to secure its international performance from 2021 to 2024. Use a MiniMax analysis to generate these actions.

7.4.4 The CAGE distance framework

We introduced the CAGE distance framework in Chapter 1. It is also well described in Ghemawat (2001, 2007). You will recall that Ghemawat argues that, for global strategy, distance still matters. Despite Friedman's (2007) argument (see Chapter 1), there are important differences between countries. The world is not globalised but **semi-globalised**. Ghemawat argues that pure global standardisation and localisation strategies will not work. International business strategy always needs to take into account the CAGE factors shown in Willcocks (2021a) p.114, figure 4.5. Refer to this now. Note that the figure shows typical bilateral differences between the USA and several Asian mainland countries. Clearly, distance and differences between the USA and these Asian mainland countries are not just geographic. There are also cultural differences, for example language, race/ethnicity, social norms and values; administrative, political and institutional differences; and economic differences (e.g. personal incomes, infrastructure, human talent). Each country will also have what Ghemawat calls 'unilateral' CAGE attributes – distinct attributes that a PESTEL analysis would highlight, and which will influence the design of international business strategy.

Ghemawat also points out that a CAGE distance analysis at country level may not suffice. In Ghemawat (2008) he also argues for a CAGE industry-level analysis and discusses the case of Mexican-based multinational Cemex and its internationalisation strategy.

Activity

1. Read Ghemawat (2001). Also read Willcocks (2021a) pp.114–17 and the case study 'Cemex and its global expansion' (VLE Chapter 7).

   Using the CAGE distance framework, assess how Cemex analysed its potential markets in its evolution to becoming a player on the global market.

   Note we will return to the Cemex case so focus here only on how Cemex analysed the international environment and fitted its strategy to the circumstances prevailing. You can find a lot of additional material on CEMEX online. Focus here only on its history to 2009.

2. Write notes on Ghemawat's 'Four C's' of Configuration, Coordination, Culture and Cosmopolitanism. What is the purpose of applying the Four C's?

7.5 Developing international business strategy: Ghemawat's AAA model

How should businesses deal with the international environments – regions, countries and industries – and the characteristics and differences uncovered by analyses like PESTEL and CAGE? Ghemawat (2007, 2018) provides an answer in his AAA framework. When looking to globalise, a company will experience a tension between the need to be responsive to local conditions and markets (adaptation) and the need to achieve economies of scale and other advantages through global integration (aggregation). It will also want to take advantage of any absolute economies it can get from operating in a different country (arbitrage). Here it is useful for you to refer to Willcocks (2021a) p.118, figure 4.6.

Look at the figure. In a foreign marketplace, the following strategies can be used:

- **Adaptation** provides the most obvious strategy for dealing with differences. The strategy is to adjust to those differences. Faced with different customer preferences the company should offer different or modified products or services and tailor policies, positioning, advertising and pricing. But such variation can be expensive and sub-strategies will be needed to reduce the costs of such variation.

- As examples, even Coca-Cola adjusts the taste of its cola to suit local preferences. A clothing retailer will be careful to ensure that its colours and materials suit the climate, as well as consumer tastes in different markets.
- **Aggregation**: The strategy here is to overcome differences, using grouping devices and intragroup coordination mechanisms to create greater economies of scale/scope than country-by-country adaptation can provide. Standardisation of products/services is just one aggregation strategy among many other possibilities. Particularly important are regional strategies that aggregate based on geography. This involves establishing, for example, regional hubs, shared service centres and marketing and sales platforms regionally. Recall that more than one half of international trade and foreign direct investment (FDI) takes place within regions. One reason is that countries in a region often have commonalities in the cultural, administrative and economic, as well as geographic, dimensions of the CAGE distance framework. But companies also aggregate along other dimensions.
- For example, Tata Consultancy Services (TCS), based in India, and one of the largest Indian IT services companies, aggregates partly by language. Uruguayan operations service Spanish-speaking markets; Hungarian operations service German-speaking countries; while TCS has also set up in Morocco to service French-speaking markets.
- **Arbitrage**: As a strategy, this exploits differences between national or regional markets by locating different parts of the supply chain in different places. As such, arbitrage represents a production or service strategy where the company focuses on absolute economies rather than scale economies gained through standardisation. Find the location where there are lower labour costs, lower resource (minerals, raw materials) or assembly costs or cheaper capital, and perhaps tax advantages. In practice, companies in every industrial and service sector have multiple arbitrage opportunities across the world, and we shall deal with this issue of sourcing and supply chain management in much more detail in Chapter 12.
- The key to successful global competitiveness is to look at the trade-offs between the three A's when entering a specific country and industry and form an integrated AAA strategy. Look again at Willcocks (2021a) figure 4.6. This summarises Ghemawat's views on what each strategy offers and how they often pull in different directions. He also discusses the example of De Beers, the African-based diamond mining and retail multinational.
- He argues that, even before a more recent strategy shift, De Beers used all three AAA strategies to engage with cross-country differences.

Activity

You are recommended at this point to read Willcocks (2021a) Chapter 4, pp.117–21, section 4.5 and Ghemawat (2007).

1. Explain De Beers' AAA strategy for dealing with cross-country differences.
2. Note from Willcocks (2021a), examples of companies that have used:
   a) adaptation
   b) aggregation
   c) arbitrage.
3. Refer back to the Cemex case study (VLE Chapter 7) and read also Ghemawat (2007) where he analyses Cemex's global moves over the years. Think about the AAA strategies Cemex starts its international expansion with, how these shift over time and why.

7.6 Choosing a strategy for international business

We have one more framework to look at. There are four basic strategies to compete in international markets. These are shown in Willcocks (2021a) p.122, figure 4.7. The appropriateness of each strategy depends on the pressures for cost reduction and local responsiveness in the industry.

Let us look at the vertical axis first. Pressures for cost reductions are greatest:

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

Pressures for local responsiveness arise from the following:

- Differences in consumer tastes and preferences – strong pressure emerges when consumer tastes and preferences differ significantly between countries.
- Differences in traditional practices and infrastructure – strong pressure emerges when there are significant differences in infrastructure and/or traditional practices between countries.
- Differences in distribution channels – there is a need to be responsive to differences in distribution channels between countries.
- Host government demands – economic and political demands imposed by host country governments may require local responsiveness.

The four basic strategies are as follows.

- **International (home replication) strategy**, which stresses the advantages of replication internationally of home country-based competencies (e.g. brand, distribution network) and products and services. Taking products first produced for the domestic market and selling them internationally with only minimal local customisation makes sense when there are low cost/global integration pressures and low pressures for local responsiveness.
- **Localisation (multi-domestic) strategy**, which considers each country or region as a stand-alone local market worthy in itself of

significant adaptation and attention. This responds to Ghemawat's adaptation requirements in strategy. The strategy involves increasing profitability by customising goods or services so that they match tastes and preferences in different national markets. This makes sense when there are substantial differences across nations with regard to consumer tastes and preferences and when cost pressures are not too intense.

- **Global standardisation strategy**, which seeks to develop and distribute standardised products/services worldwide to reap the benefits of economies of scale and shared product development. This is Ghemawat's aggregation goal, namely to increase profitability and profit growth by reaping the cost reductions from economies of scale, learning effects and location economies. This makes sense when there are strong pressures for cost reductions and demands for local responsiveness are minimal.
- **Transnational strategy**, which aims to capture the 'best of both worlds' by endeavouring to be both cost efficient (aggregation focus) and locally responsive (adaptation focus). This tries to simultaneously achieve low costs through location economies, economies of scale and learning effects; differentiate the product offering across geographic markets to account for local differences; and foster a multidirectional flow of skills between different subsidiaries in the company's global network of operations. This makes sense when cost pressures are intense and strong and pressures for local responsiveness are intense.

Note that an international/home replication strategy may not be viable in the long term. To survive, companies may need to shift to a global standardisation strategy or a transnational strategy in advance of competitors. A localisation strategy may give a company a competitive edge, but if the company is simultaneously facing aggressive competitors, the company will also have to reduce its cost structures. This would require a shift towards a more transnational strategy. Willcocks (2021a) p.125, figure 4.8 captures some typical shifts in strategy as a business seeks to improve its global positioning,

Activity

Now read Willcocks (2021a) Chapter 4, especially pp.121–27, sections 4.6 and 4.7, to consolidate your learning on these points. It is useful to note examples of companies that adopted any of these strategies, or which had to shift strategy.

7.7 Key concepts

The key concepts in this chapter are:

- strategy
- value creation
- value chain analysis
- economies of location, experience effects and scale
- environmental analysis: PESTEL, SWOT, Minimax, CAGE
- Ghemawat's AAA strategies
- internationalisation (home replication), localisation, global standardisation and transnational strategies.

7.8 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define the concepts of strategy, value creation and the value chain of a company
- apply these concepts to real-life cases in international business
- identify economies from location, experience effects and scale, and apply these ideas to strategy development in international business
- describe the major components of an environmental analysis and apply the PESTEL, SWOT, Minimax and CAGE frameworks to actual cases
- explain how to develop international business strategy for an organisation using Ghemawat's AAA model and choosing a developmental path across the four basic international strategy types, namely international (home replication), localisation, global standardisation and transnational strategies.

7.9 Test your knowledge and understanding

Reconsider the Cemex case you have already read in terms of the framework shown in Willcocks (2021a) figure 4.7.

1. Where did Cemex's strategy start and how did it shift? Why?
2. Assess how Cemex balanced adaptation, aggregation and arbitrage at different points in its journey through the figure 4.1 framework. Did it make any mistakes? Would you have done anything differently? Why?

7.10 Sample examination question

'In the face of high environmental turbulence and uncertainty, and intense competition, an international business relies increasingly for direction on strong analytical frameworks.'

Discuss this statement by answering the following questions. Use illustrative examples throughout:

a. Describe the SWOT, CAGE and PESTEL frameworks and how they can be used for environmental analysis.

b. Describe and assess the usefulness for strategic analysis of Ghemawat's AAA.

c. Describe the Minimax framework. Explain how it can be used. Provide an illustrative worked example, using an international business you are familiar with, (e.g. your national airline, a major bank).

Notes

Chapter 8: Competitive strategy for international business

8.1 Introduction

At this point, we make a distinction between three types of strategy. Business level or competitive strategy – the subject of this chapter – focuses on how individual businesses should compete in their particular markets. There is also corporate level strategy that concerns the overall scope of a company and how value is added and synergies achieved across a company's several business units taken as whole. We deal with this issue in Chapter 9. Then there are the operational strategies, where the focus falls on how the components of an organisation deliver effectively the corporate and business level strategies in terms of resources, processes and people. Operational strategies are primarily covered in Part 4 of this guide, with the chapters on organisation, sourcing, information systems, human resources and digital management (see also Willcocks, 2021b).

An **industry** is a group of companies producing goods (products/services) that are similar to each other. There may be thousands of companies offering similar goods/services in perfect competition. Here entry barriers are low, there are many equal rivals each with similar products, and information about competitors is freely available. An example is taxicab services in large cities throughout the world. More typically, there are relatively few organisations in direct competition. At the other extreme, a monopoly is where only one company provides the goods/services for an industry. A duopoly is where two companies dominate the industry. An oligopoly is where a few companies control an industry.

A **market** is a group of customers for specific products or services that are similar to each other. Thus Honda operates in the world's automobile market and will sell its range of cars in markets like the USA, Europe and Japan, with intensive competition from other automakers like Toyota, BMW, General Motors, Citroen etc. across its entire car range.

In this chapter we focus on frameworks that help us analyse competitive forces in an industry; the generic strategies a company can adopt in order to compete; the resource-based view of competition; and the importance of Peng and Meyer's (2019) institution-based view of competitiveness. We also look at more recently developed approaches to and views on strategy, which show how environment and strategy can be more closely aligned, and the myths and realities of strategy in the contemporary environment after the 2020–21 crisis.

8.1.1 Aims of the chapter

The aims of this chapter are to:

- introduce the work of Michael Porter on competitiveness and strategy, including his five forces and generic strategies frameworks
- identify the strengths and weaknesses of Porter's positioning approach to strategy
- explain the resource based approach to competitiveness as an alternative and complementary mode of analysis and management practice

- describe the VRIO framework – value, rarity, inimitability, organisation – as a mode of resource-based analysis
- provide a platform for debating the relative strengths of positioning, resource-based and institutional perspectives on achieving competitiveness
- give insight into how to choose the right position, leverage, or opportunity strategy
- debate contemporary views on business strategy and competitiveness.

8.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- describe, assess and apply the five forces framework for industry analysis
- summarise the generic strategies of cost leadership, differentiation and focus
- define and assess the resource-based approach to competition, and how tangible and intangible resources and capabilities can be utilised to achieve competitiveness
- apply the VRIO framework to organisational examples to assess the strengths and weaknesses of a business
- outline the institution-based view on international competitiveness.
- explain how to choose the right position, leverage, or opportunity strategy
- participate in the major contemporary debates arising from the study of competitive strategy for international business.

8.1.3 Essential reading

Willcocks, L. *Global business: strategy in context*. (Stratford-upon-Avon: SB Publishing, 2021a) Chapter 5.

Plus:

Bingham, C., K. Eisenhardt, and N. Furr ‘Which strategy, when?’, *Sloan Management Review* Strategy Guide Book, (Boston: SMR, 2015).

8.1.4 Further reading

Barney, J. ‘Is the resource-based view a useful perspective for strategic management research?’, *Academy of Management Review* 26 2001, pp.41–56.

Decker, C. and T. Mellewigt ‘Thirty years after Michael E. Porter’, *Academy of Management Perspectives* 21 2007, pp.41–55.

Peng, M. ‘The resource-based view and international business’, *Journal of Management* 27 2001, pp.803–29.

Peng, M., D. Wang and Y. Jiang ‘An institution-based view of international business strategy’, *Journal of International Business* 39 2008, pp.920–36.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapters 4, 13 and 14.

8.1.5 References cited

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Peteraf, M., 'The foundation of competitive advantage: a resource-based view', *Strategic Management Journal* 14 2003, pp.179–91.

Sigglekow, M. and A. Terwiesch *Connected strategy*. (Boston: Harvard Business Review Press, 2019).

Teece, D., G. Pisano and A. Shuen 'Dynamic capabilities and strategic management', *Strategic Management Journal* 18 1997, pp.509–33.

8.1.6 Synopsis of chapter content

Competitive strategy analysis using Porter's Five Forces framework; the nature of generic strategies; a resource-based perspective on international competitiveness; the value, rarity, inimitability, organisation (VRIO) framework; institution based view of competition; assessing positioning and resource-based approaches, positioning, leverage and opportunity strategies; contemporary strategy debates.

8.2 Porter's five forces framework

Michael Porter developed his five forces model to identify an industry's structure, and whether or not it was an attractive industry for a business unit to compete in. Porter's framework helps a business to position itself advantageously relative to its competitors. The five forces are shown in Willcocks (2021a) p.130, figure 5.1. You need to refer to this now. We discuss each of them below.

8.2.1 Rivalry between competitors

Competitive rivals are organisations with similar products and services aimed at the same customer group and are direct competitors in the same industry/market (they are distinct from substitutes). For example, in Europe Air France and British Airways compete directly for airline passengers. Trains are a substitute service. The degree of rivalry is increased when:

- Competitors are of roughly equal size.
- Competitors are aggressive in seeking leadership.
- The market is mature or declining.
- There are high fixed costs (e.g. industries requiring high capital equipment costs like the steel industry).
- The exit barriers are high, for example due to high costs of redundancy or the decommissioning of capital equipment that is not easily re-saleable.
- There is a low level of differentiation. Differentiation can be by, for example, providing goods/services with different attributes such as colour and shape of tennis racket, battery length in a portable computer, or by pricing the goods/services differently, or by branding.

Willcocks (2021a) p.132, figure 5.2 gives an example of competitive rivalry in the global automobile industry. Look at this now. Note that there are different markets for different types of car, and that products and related services are differentiated by factors like price and prestige. Looking at Willcocks (2021a) figure 5.2 from a customer perspective, there are three markets – mass, luxury and ultra-luxury. We call each a **market segment** (i.e. a group of customers with similar needs, different from customer needs in other parts of the market).

8.2.2 The threat of entry by new rivals and barriers to their entry

Barriers to entry are the factors that need to be overcome by new entrants if they are to compete in an industry. The threat of rival entry is low when they are kept out by high entry barriers such as:

- Economies of scale/high fixed costs. The steel and semi-conductor industries are just two examples.
- Non-scale-based advantages, for example patents, difficult to imitate know-how, superior information about customers.
- High experience and learning needed to succeed in the industry.
- Difficulty in accessing supply and distribution channels.
- High differentiation and market penetration costs – typical for the products shown in Willcocks (2021a) figure 5.2.
- Difficult government restrictions (e.g. licensing, tax regimes).
- Possible retaliation by existing firms in the market, for example slashing prices against a new rival setting up in the UK newspaper industry.

Activity

You want to start an internet-based travel business offering services to domestic and foreign customers. What entry barriers exist? What would you need to do to deal with these barriers and set up your business?

8.2.3 Threat of substitutes

Substitutes are products or services that offer a similar benefit to an industry's products or services, but by a different process. For example, in India Tata's 'one lakh' car may become a substitute for motorcycles and rickshaws, initially in Indian cities, but then as an export abroad. Customers will switch to alternatives (and thus the threat increases) if:

- the price/performance ratio of the substitute is superior (e.g. aluminium may be more expensive than steel but it is more cost efficient for some car parts)
- the substitute benefits from an innovation that improves customer satisfaction (e.g. high speed trains can be quicker than airlines from city centre to city centre such as in Europe, London to Paris).

8.2.4 The bargaining power of buyers

Buyers are the organisation's immediate customers, although not necessarily the ultimate consumers. For example, for a company like Proctor and Gamble – who make detergents, shampoos and hundreds of related products – their customers are stores like Carrefour, Marks and Spencer and Safeway. If buyers are powerful, then they can demand cheap prices or product/service improvements to reduce profits. Buyer power is likely to be high when:

- Buyers have low switching costs, meaning they can switch easily between suppliers. Switching costs are low when the item bought is a weakly differentiated commodity and is easily available (e.g. sugar).
- Buyers can supply their own inputs (backward vertical integration). For example, some Chinese steel companies have gained power over their iron ore suppliers by acquiring iron ore sources for themselves, putting them in a strong bargaining position relative to their existing suppliers.
- A few buyers account for the majority of sales.

8.2.5 The bargaining power of suppliers

Suppliers are those who supply what organisations need in order to create the product or service. Powerful suppliers can eat into an organisation's profits. Supplier power is likely to be high when:

- There are very few of them and they provide a specialist or rare input.
- Buyers represent only a small part of sales by the supplier.
- Switching costs are high and it is disruptive or expensive to change suppliers (for example, Microsoft is a powerful supplier in the PC industry because of the high switching costs of moving from one operating system to another).
- Suppliers can integrate forwards (for example, low cost airlines have cut out the use of travel agents).

Activity

Read the case study of 'The changing steel industry' (VLE Chapter 8).

1. In recent years, which of the five forces has become more positive for steel producers and which less so?
2. Explain the acquisition strategies of players such as Mittal, Tata and Nucor.
3. In the future, and following the 2020–21 crisis, what may change to make the steel industry more or less attractive?

8.2.6 Use and criticisms of Porter's five forces framework

With the five forces framework you are trying to assess the attractiveness of an industry, and how to make it more attractive, from a business perspective. It is important, therefore, to ask:

- Should we enter or leave this industry?
- What leverage can we exert to improve our chances of success?
- How are competitors reacting to the five forces, and how will they react to moves we make?

The five forces framework is a useful tool but must be applied carefully. Criticisms include the following:

- The framework is applied at the most **appropriate level** – not necessarily the whole industry.
- A five forces analysis may assume too much stability. In most modern competitive environments there is a higher dynamism than Porter assumed when he designed the framework back in 1985.
- Five forces analysis tends to neglect the growing importance of **complementors**. An organisation is your complementor when a) customers value your product more if they use it along with the other company's product/service than when they use your product alone, and b) it is more attractive for suppliers to provide resources to both you and the other organisation(s), rather than to you alone. For example, Microsoft Windows and McAfee computer security systems are type a) complements. Boeing in its relationships to airlines is a type b) example. Here, Boeing invests huge sums in innovation because it has so many airlines as potential customers.
- The view of competition inherent in the five forces framework assumes that in conditions of high market uncertainty the company is best advised to integrate backwards to compete with suppliers, or forwards

to compete with buyers in order to lessen the threats from these two sources. But in the modern environment there may be advantages in the alternative approach of outsourcing (see Chapter 12).

- The industry-positioning perspective that the five forces framework represents has been challenged by the resource-based perspective on competition – see below and Peng (2001). It has also been challenged by the idea of institution-specific determinants of company performance (see Peng et al., 2008). For a broader assessment see Decker and Mellewigt (2007).

8.3 Generic strategies

Having analysed the macro-environment and the competitive forces in industry and the marketplace, a company next needs to make strategic choices. Porter's work is again a useful starting point. He suggests three generic strategies to choose from. See Willcocks (2021a) p.137, figure 5.3.

8.3.1 Cost leadership

This competitive strategy centres on competing through low costs and prices. It is achieved through approaches such as the relentless pursuit of cost reductions and overhead control, avoidance of marginal customers and cost minimisations in non-key areas like R&D, marketing, service and perhaps advertising. The idea is to offer better value to customers through the same value at a lower price.

The strategy has some weaknesses. A relentless drive to cut costs might compromise value that customers desire. Only competing on price leaves little room for competitive manoeuvre if a competitor finds ways of reducing their own costs (e.g. innovating in its supply chain or finding a substitute product). Consider the impact on world markets if Tata exported its 'one lakh' car mentioned above. The Tata Nano car sold initially for $US 3,000 in India, while abroad, competitors' cheapest cars were selling for $US 8,000–10,000.

8.3.2 Differentiation

A differentiation strategy delivers products/services that customers perceive to be valuable and different, even unique. Here a company targets customers in smaller, well-defined segments who are willing to pay premium prices. It takes a low volume, high margin approach. The strategy is dependent on products/services with unique attributes (actual or perceived), for example, in terms of quality, sophistication, prestige or luxury. Key functional areas are R&D (as a source of innovation), marketing/sales and after-sales services. But note that differentiation also erodes and becomes commoditised as competitors find ways of replicating the original product.

Mathur and Kenyon (2015) stress that differentiation is a key weapon in competitive strategy. A business needs to continually revisit customer preferences. These cover what the authors call **merchandise** factors What **content** do they really want? Are they concerned about the **aura** – what the product says about the customer? For example you may buy a sports car, not so much because of its functionality, but as much because it says you are an exciting, colourful, risk taker for example. Then again, there are **support** factors. How **personalised** does the customer want the vehicle? What colour, shape of wing mirrors, leather seats are required? How much **expertise** support do they need when buying and after sales, when they are driving the car?

Mathur and Kenyon (2015) suggest that customers preferences vary between four main purchases: 'commodity', 'service', 'product' and 'system'. Willcocks (2021a) p.139 describe these, and provide the examples of BMW, and also of tennis rackets. You might want to look at this now.

8.3.3 Focus (or niche) strategy

Here a company concentrates on serving the needs of a particular segment or niche of an industry such as a geographical market, type of customer or product line. A specialised differentiator has a smaller, narrower and sharper focus than a large differentiator. For example, Japanese shipbuilders tend to build high quality vessels at high prices, and at premium prices for the global market. Scandinavian shipbuilders tend to narrow their focus to building icebreakers, cruise ships and other specialised vessels.

A specialised cost leader deals with a narrower segment compared with the traditional cost leader. Focusing is particularly successful when a company possesses intimate knowledge of a particular market segment. India's large IT outsourcing firms such as TCS, Wipro and Infosys throughout the early and mid 2000s competed successfully against much larger firms such as Accenture, Hewlett Packard and IBM because they focused on providing good quality at lower costs for IT support, maintenance and development work. Lower costs came from lower labour costs in India and the adoption of process methodologies.

Activity

Read Decker and Mellewigt (2007) then answer the following questions.

1. Assess the strengths and weaknesses of Michael Porter's work that emerge from this article. Take notes on these to help you answer a possible examination question on this topic.
2. Also read Willcocks (2021a) Chapter 5, especially sections 5.1 to 5.2 to see a more detailed critique of Porter.
3. Look at Willcocks (2021a) pp.137–40, section 5.3. Ensure that you understand the concept of differentiation and can give examples of how a business differentiates its offerings to its customers. You can draw upon your own purchasing experience here (e.g. buying a computer, a mobile phone, a car).

8.4 A resource-based perspective of competitiveness

The industry-based view detailed so far focuses on competitive positioning in relation to external opportunities and threats (see Chapter 7). The resource-based view we now discuss focuses on the resources and capabilities needed to compete and deals with the internal strengths and weaknesses of the company (also in Chapter 7). The most fundamental questions asked by the resource-based view are: do the resources add value? Do they enable a company to exploit an external opportunity and/or neutralise an external threat?

Resources are the tangible and intangible assets a company uses to choose and implement its strategies. Capabilities are a company's capacity to technically deploy those resources to deliver strategy.

Refer now to Willcocks (2021a) p.141, figure 5.4.

- **Tangible assets** are assets that are observable and more easily quantified. Financial assets include internal funds such as shareholders' capital and retained profits, as well as external capital, like loans provided by banks. Physical assets include plants, offices, infrastructure and equipment, as well as inventories of raw materials, components and finished goods. Technological resources include patents, trademarks and copyrights that entitle the company to intellectual property rights and enable it to generate valuable products.

- **Intangible assets** are also found on companies' balance sheets, but they are harder to value, difficult to codify and hard to observe. Nevertheless, Hastel and Westlake (2018) estimate that by around 2008 intangible investments in US and European firms were exceeding tangible investments, and that the disparity has increased since. The increasing dependence on intangibles for competitive advantage correlates with the development of the finance industry ('financialisation') but also the rise of digital technologies, producing intangibles like data, software, virtual business, communications process for example. Intangibles also have different economic characteristics, that can give competitive advantage. You might like to think what these characteristics might be. Willcocks (2021a) p.143 will give you some ideas.

Reputational resources are the company's goodwill, brand names and business relationships.

Goodwill is the value of abilities to develop and leverage the company's reputation as a solid provider of goods and services, an attractive employer and/or a socially responsible corporate citizen. Reputation can be regarded as an outcome of a competitive process in which companies gain and signal prestige in specific areas important for competing effectively. Innovation capabilities are increasingly highly valued across industries, particularly in hi-tech firms like Samsung, IBM and Microsoft.

Human resources (or human capital) are embedded in the individuals working in an organisation. They include:

- individual employees' skills, talent and knowledge
- individual employees' capacity for collaboration and communication
- employees' abilities for interpersonal interaction that are not captured by a company's formal systems and structures
- employees' shared values, traditions and social norms within an organisation.

Financial analysts may take human resources for granted, but many companies regard them as a foundation of all their capabilities. Knowledge capabilities are highly valued as company-specific intangible abilities to use resources to achieve organisational goals.

No company can generate competitive advantage by relying only on primary resources. As we saw in Chapter 7, most goods and services are produced through a chain of vertical activities (from upstream to downstream) that add value – in short, a value chain. Many of the most important capabilities in today's business world relate to abilities to connect different stages of the value chain, for example:

- capabilities in innovation – a company's assets and skills to (1) research and develop new products and services and (2) innovate and change ways of organising
- capabilities in operations – a company's ability to effectively implement its regular activities, notably the manufacturing process
- capabilities in marketing – to enable companies to develop and sustain brand awareness and values and to induce consumers to buy these brands

While all such capabilities can contribute to competitive advantage, some may become primary for a company in specific circumstances. For example, Walmart today is the biggest retail company in the world. It does not make a single thing. All it 'makes' is a hyper-efficient supply chain. Its logistics capabilities were born from being initially located in low-cost Arkansas, USA. Its logistics capabilities give Walmart speed, scale and cost advantages over rivals, and also enable Walmart to provide logistics advice and services to other companies.

One of the critical questions on capabilities a company must answer is whether a capability is critical enough to be kept in-house, or whether it is not a core critical capability and can be outsourced, or can be the subject of a strong partnering relationship with another company or service supplier. We address this question in depth in Chapter 12.

Activity

Search online for material on the history of Amazon. Review the history then answer the following questions:

1. What were Amazon's starting capabilities?
2. What capabilities did it need to develop to become profitable?
3. What capabilities does it now have, and how are they leveraged?
4. Do you think it was a good move for booksellers who failed with their online operations to outsource the service to Amazon to run it for them?

8.5 Resource-based competition: the VRIO framework

Willcocks(2021a) Chapter 5, pp.141–47 sections 5.4–5.5 gives a good overview of resource-based competition and the VRIO framework and you are recommended to read it thoroughly. Note especially its many examples.

VRIO is a resource-based framework that focuses on the value (V), rarity (R), imitability (I) and organisational (O) aspects of resources and capabilities. Note that, in other books, you may also come across the VRIN framework. The difference here is the N. In the VRIN framework N stands for non-substitutability. This refers to non-substitutability of products/ services, but also importantly to non-substitutable competencies. Peng and Meyer (2019) argues for the need to replace this attribute with the more general one of organisation, seeing the distinctive characteristics and abilities of the organisation built over years as a guard against easy competence substitution. Here we work with the VRIO framework put forward by Peng and Meyer (2019).

VRIO poses four fundamental questions:

- **Value**: Do resources and capabilities exist that are valued by customers and provide potential competitive advantage? Adding value is necessary for achieving competitive advantage.
- **Rarity**: How rare are the valuable resources and capabilities? Do capabilities exist that no, or few, competitors possess? Valuable but common resources do not give an advantage (e.g. water as a cooling agent in wet weather countries; however, in hot, dry countries water might be both valuable and rare and its access prized).
- **Imitability**: How easy is it to replicate the resources/capability? Generally, it is easier to imitate tangible resources/capabilities – for example, a manufacturing plant – than intangible ones, for example tacit knowledge, managerial talent, superior motivation. There are

two ways to imitate – direct duplication and substitution. Direct duplication is the more difficult because it is hard to acquire in a short time what competitors have developed over a long time. It is also difficult for a competitor to identify the causal determinants of a company's performance.

- **Organisation**: How is a company organised to develop and leverage the full potential of its resources and capabilities? For example, in the movie business film stars are valuable, rare and hard to imitate but they need a studio and an organisation to make the film into a success. This involves using complementary assets – for example, film crews, directors, make-up artists, business managers, etc. It also involves socially complex ways of organising, for example overcoming cultural differences, establishing strong human relationships by which activity can be facilitated. Thus a distinctive organisation that gives competitive advantage is dependent on using complementary assets effectively; managing social complexity effectively; and leveraging invisible relationships that can add value – because this makes imitation much more difficult.

Refer now to Willcocks (2021a) p.146, figure 5.5. This is based on Peng and Meyer (2019) and their theory of resource-based competitive advantage. Figure 5.5 shows the growing competitive advantage from a company developing specific resources and capabilities that are valuable, rare, non-imitable and are supported by distinctive organisational capabilities. Valuable, rare, but imitable resources/capabilities can give temporary advantage. Only valuable, rare and hard-to-imitate resources/capabilities backed by distinctive organisation can provide a sustained competitive advantage.

Activity

Read Willcocks (2021a) Chapter 5, pp.141–47, sections 5.4 and 5.5 to consolidate your learning and add new points and cases to your revision notes.

Look at the 'Portman-Ritz-Carlton, Shanghai' case study (VLE Chapter 8), then answer the following questions:

1. What is the main source behind the Portman-Ritz-Carlton's performance?
2. How valuable, rare and hard to imitate are its human resources?
3. How organisationally embedded are its capabilities?
4. If you were the general manager of a rival hotel, how would you respond?

8.6 Bringing environment and strategy together

The dynamic, unpredictable and uncertain international business environment of the 2020s makes contingency approaches to developing business strategy even more valuable. The work of Bingham, Eisenhardt and Furr (2015) on adapting strategy to fit with competitive positioning, resource-base and environment is particularly relevant to today, and bring together a number of approaches described separately in the chapter.

They suggest that competitive strategy has to be disaggregated into three possible strategies. These are described in Willcocks (2021a) p.149, figure 5.6:

- **Positioning** strategy, for stable business environments. A business gains competitive advantage here by choosing a valuable and unoccupied strategic position in a given industry, and by creating and linking company resources to defend that position. A weakness is that a positioning strategy these days is its vulnerability to environmental change and intensifying competition in most markets.

- **Leverage** strategy, for moderately dynamic environments. Here competitive advantage is achieved by using strategically important resources in existing and new industries at a pace consistent with moderate changes in the market. This strategy is based on taking a resource-based view of competitive advantage. One problem is the timing and updating of the resource portfolio as industries and customer preferences change.
- **Opportunity** strategy, for dynamic environments where customer preferences change fast, likewise competitors and business models. In place of strategic planning, managers need to learn and deploy simple rules, which provide enough structure for action, whilst also allowing flexibility to exploit unanticipated opportunities. However the risk of getting timing and focus wrong are higher in fast moving environments. On the other hand, large companies generally have too much structure and this may, despite the strategy, slow down their ability to exploit opportunities.

How to arrive at the right strategy? Bingham, Eisenhardt and Furr (2015) suggest a process that brings together the environmental analysis tools, and the institution-based, competitive positioning, and resourced based approaches described earlier, showing how they can be used in a complementary way:

1. understand your circumstances
2. take stock of your resources
3. establish the relationships between resources
4. identify the source of competitive advantage
5. choose the relevant strategy.

Activity

Now read carefully Willcocks (2021a) pp.147–52, section 5.6, and answer the following:

1. Assess when the positioning, leveraging and opportunity strategies are best utilised. Give illustrative business examples of the strategies being deployed.
2. Assess the weaknesses and risks of each of these strategies.
3. Why did Amazon run into difficulties with its leverage strategy?
4. Describe the positioning strategy of the Vanguard Group.
5. Describe how Pixar Animation Studios uses 'simple rules'.
6. Why did Google go abroad, using an opportunity strategy?

8.7 Debates and an institution-based view of competition

There are a number of controversies that are worth looking at. The older debates consider the relative superiority of the institution-based, resource based and competitive positioning approaches. The newer debates look at how strategy is best conducted in contemporary uncertain and dynamic business environments.

- One interesting question is whether the competitive industry positioning approach that Michael Porter and others advance helps a company compete better than the firm-specific resource-based approach. While many arguments and much evidence are marshalled to answer this question, the truth is that they are probably best seen as complementary lenses. Both provide different, useful insights on how a company can compete successfully in international business.

- In the last 10 years there has been much greater emphasis on the need for dynamic capabilities that are most frequently knowledge-based. There are dangers in investing in static capabilities whose differentiating, valuable, rare and organisationally supported attributes commoditise and become less valuable over time.
- Should the firm's resources and capabilities be retained in-house or can they be outsourced? Can they be offshored? What are the limits to offshoring and outsourcing? How can we avoid 'hollowing out' the organisation? We will look at these issues in detail in Chapter 12.
- What about international capabilities? Do companies that are successful domestically have what it takes to win internationally? There is some evidence that it takes additional capabilities to move into overseas markets. In the mid-2000s Walmart withdrew from Germany and South Korea. Its main French-based competitor Carrefour also exited Japan, Mexico, Slovakia and South Korea. At the same time, the Scandinavian furniture company IKEA has found its style of flat-pack packaging and sales is popular in many global markets. Companies like Zara, United Colors of Benetton and Gucci are successful in major cities around the world. Reasons for successful market entry can be found in Chapter 9.
- We dealt with an institution-based view of competition in Chapters 2 and 3. Peng and Meyer (2019) and Peng, Wang and Jiang (2008) are particularly strong on this perspective. If you are asked to assess the industry positioning and resource-based approaches to competition, it is helpful to be aware of Peng et al.'s (2008) point that, especially when it comes to international competitiveness, formal and informal institutions greatly affect and shape the strategies that are possible in specific countries and markets – something that the industry positioning and resource-based approaches tend to downplay and even neglect.
- There has been newer thinking on strategy. For example, Siggelkow and Terwiesch (2019) see businesses gaining competitive advantage increasingly by focusing on much longer-term customer relationships, and doing this at lower cost. Their idea of a four-phase process called the four Rs (recognise, request, respond, repeat) link well with the managing across the customer life cycle idea, which we discuss in detail in Chapter 10. Bungay (2019) wants to debunk five myths about strategy, and this makes interesting preparation for businesses operating in the 2020s international business environment.

Activity

Read Willcocks (2021a) Chapter 5, pp.152–57, sections 5.7 and 5.8 for more arguments and debating points. Note these for revision purposes. Answer the following questions to test your understanding:

1. Why in the 2020's business environment would international business increasingly move more to their domestic, or regional markets, and away from globalisation?
2. Is Amazon a good example of the Siggelkow and Terwiesch (2019) suggestions?
3. What are the five myths, and the truths, about strategy that Bungay (2019) discusses?

8.8 Key concepts

The key concepts in this chapter are:

- threat of new entrants, threat of substitutes, competitive rivalry, buyer power, supplier power
- the five forces framework analysis
- generic strategies of cost leadership, differentiation and focus
- resource-based perspective and tangible and intangible resources
- the value, rarity, imitability, organisation (VRIO) framework
- institution-based approach to competitiveness
- position, leverage and opportunity strategies
- contemporary strategy and competitiveness debates.

8.9 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- describe, assess and apply the five forces framework for industry analysis
- summarise the generic strategies of cost leadership, differentiation and focus
- define and assess the resource-based approach to competition, and how tangible and intangible resources and capabilities can be utilised to achieve competitiveness
- apply the VRIO framework to organisational examples to assess the strengths and weaknesses of a business
- outline the institution-based view on international competitiveness.
- explain how to choose the right position, leverage, or opportunity strategy
- participate in the major contemporary debates arising from the study of competitive strategy for international business.

8.10 Test your knowledge and understanding new case needed?

Read the Rolls Royce case study (VLE Chapter 8). The case provides an opportunity to check your understanding of Chapters 7 and 8 and how companies compete in international business.

Answer the following questions:

1. From the perspective of the institution-based view:
    a. How did the First and Second World Wars influence the long-term development of the company?
    b. How did US defence policy influence the development of RR?
    c. How did UK government policy influence the development of RR?
2. From the perspective of the resource-based view:
    a. Which resources were the sources of competitive advantage of RR in 2009?
    b. What dynamic capabilities does RR have that have helped at different stages of its development?

   c. If there was a new entrant in the market for aircraft engines, where would you expect it to come from?

3. From a Porter frameworks point of view: Assess the changing position of RR over the years using Porter's generic strategies framework and five forces framework for your analysis.

8.11 Sample examination question

'The resource-based view of strategy has replaced competitive positioning as the key to strategic advantage.'

a. Describe Porter's competitive positioning frameworks for five forces and generic strategies.

b. Describe the essentials of a resource-based approach to competitive advantage.

c. Critically assess the value of these two approaches in international business environments against the role of the institution-based approach.

Chapter 9: Entry strategies, alliances and evolution

9.1 Introduction

In Chapter 4 we looked at foreign direct investment. FDI occurs when a company invests directly in facilities to produce and/or market their products or services in a foreign country. Once a company undertakes FDI it becomes, by definition, a multinational enterprise or MNE. However, entering a foreign market is not that simple, and the 2020–21 pandemic and economic crisis has not made it simpler. There are four major decisions to make: why enter a foreign market, which market(s) to enter, when to enter the market(s) and on what scale? There are also major options available as to how to enter a foreign market.

In this chapter, we discuss these options and their advantages and disadvantages. You will learn about exporting, turnkey projects, licensing, franchising, joint ventures, as well as fully owned subsidiaries. You will also learn about when to establish strategic alliances, and how to make these work. Finally, and connecting back to Chapter 7, you will learn how companies evolve their international strategy in order to seek optimal location, organisational arrangements and returns.

9.1.1 Aims of the chapter

The aims of this chapter are to:

- establish the major decisions a firm needs to make when entering an international market
- assess the role of foreign direct investment in entering a new market
- identify the six modes of foreign market entry and their advantages and risks, and the key criteria that shapes a firm's choice
- introduce and establish the relative merits of strategic alliances, acquisitions and green and brown field strategies as modes of foreign market entry
- identify how firms evolve their presence internationally over time, and the strategies they can adopt.

9.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- explain the four decisions a company must address when entering foreign markets: why enter a foreign market, which market(s) to enter, when to enter the market(s) and on what scale and level of ownership
- describe the advantages and disadvantages of the major ways that small and medium enterprises (SMEs) and multinational enterprises (MNEs) can enter foreign markets
- identify the key factors that shape a company's choice of entry mode
- discuss the advantages of acquisitions versus greenfield ventures as entry strategies
- explain why companies enter into strategic alliances and the factors that can make such an entry mode effective or ineffective

- determine how individual companies evolve and expand their international presence.

9.1.3 Essential reading

Willcocks, L. *Global business: strategy in context*. (Stratford-upon-Avon: SB Publishing, 2021a) Chapter 6.

9.1.4 Further reading

Cantwell, J. et al. 'An evolutionary approach to understanding international business activity', *Journal of International Business* 41 2010, pp.567–86.

Ghemawat, P. *The new global road map: enduring strategies for turbulent times*. (Boston: Harvard Business Review Press, 2018).

Hennart, J. 'Down with MNE-centric theories! Market entry and expansion as the bundling of MNE and local assets', *Journal of International Business* 40 2010, pp.1432–54.

Hoffmann, W., 'Strategies for managing a portfolio of alliances', *Strategic Management Journal* 28 2007, pp.827–56.

Khanna, T. and K. Palepu 'Emerging giants: building world class companies in developing countries', *Harvard Business Review* 84(10) 2006, pp.60–69.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapters 11, 12 and 14.

Rothaermal, F., S. Kotha et al. 'International market entry by US internet firms', *Journal of Management* 32(1) 2006 pp.56–82.

Tanev, S., 'Global from the start: the characteristics of born global firms in the technology sector', *Technology Innovation Management Review* March 2012, pp.5–8.

9.1.5 Synopsis of chapter content

How to make decisions to enter foreign markets; six modes of foreign market entry; their advantages and disadvantages; role of strategic alliances; acquisitions; greenfield and brownfield sites; growth through evolution – four typical stages, strategies and organisational forms.

9.2 The decision to enter foreign markets

The decision to enter a foreign market breaks down into four decisions. If you are a small or medium enterprise (SME) your reasons and decisions may be very different from those of a multinational (MNE). We will consider both kinds of enterprises here, though the main focus will be on MNEs.

9.2.1 Why enter a foreign market?

The obvious reason to seek foreign markets is to expand sales revenues. Consider the case of the Russian company Kaspersky Lab. The product here is anti-virus software for home and company use. This is easily adaptable for international markets. The company started very small in 1997 but by 2008 was the fourth largest supplier in the world. They did this by gaining funding, firstly through foreign licensing agreements, expanding using foreign sales partners, then launching local offices, initially in the UK, Poland, Holland and China, but then other countries were gradually added. Its dramatically successful growth is one that many SMEs seek to replicate, though each has its own distinctive set of challenges on the road to internationalisation.

Some MNEs, on the other hand, may well have sufficient financial resources and be mature enough to act on a larger-scale and longer-term basis and be able to invest directly in establishing subsidiaries abroad. Peng and Meyer (2019) suggest that such investments have one or more of four common objectives, as follows:

- natural resource-seeking
- market-seeking
- efficiency-seeking
- innovation-seeking.

More often, a company's first entry into foreign markets is the start of a long-term evolution towards internationalisation and becoming a multinational. In this respect, consider the history of Pearl River Piano founded in 1956 (see Willcocks, 2021a, p.161). Global competition pushed a strategy of exports, greenfield investments and acquisitions over time. By 2021 Pearl River pianos were being manufactured under a wide range of brands. By this date the company was capable of producing over 10,000 pianos a year, and exporting them, in a normal year, to over 80 countries. See Willcocks (2021a) pp.160–61 for more discussion of why organisations enter new markets.

9.2.2 Which markets to enter?

The answer to this question depends on the company's objectives. A market-seeking company looks at size of a market and the present and future purchasing power of consumers there. Chapters 2, 3, 4, 5 and 6 of this guide examined a range of factors that shape the overall attractiveness, or otherwise, of a particular regional, national or intra-national marketplace. Also important is the level of domestic and foreign competition experienced in that foreign market. **Natural resource-seeking** companies, for example looking for oil or gas deposits, seek quantity, quality and low-cost resources, as do **efficiency-seeking** companies wanting – typically – low cost, productive and reliable local workforces (e.g. software developers and engineers in India, call centre operatives in South Africa). But for efficiency-seeking companies, **total cost**, not just labour costs, is a vital calculation.

9.2.3 When to enter?

Entering a market before competitors can give first-mover advantages. These include:

- pre-empting rivals by establishing a strong brand name
- building up sales volume and riding down the experience curve ahead of rivals, gaining a cost advantage over later entrants
- creating switching costs that tie customers to products or services, making it difficult for later entrants to win business.

However, being a first mover can also have risks and disadvantages, including:

- the risks and costs of business failure, if inexperience in the foreign market leads to major mistakes
- pioneering costs where the foreign business environment is so different that major time, effort and expense has to be incurred
- costs of promoting and establishing a product offering and brand.

Late movers can gain certain advantages that first movers may not enjoy. Examples include taking advantage of a first mover's investments in educating customers, learning about the market and what works managerially; letting the market and technological uncertainties be sorted out by the first mover before entering the market; being able to leapfrog the early mover by being in a position to differentiate products/services more precisely.

9.2.4 Scale and ownership

Clearly, entering a foreign market incurs risk. If the decision is to seize a large market opportunity and make a strategic commitment, then MNEs will look at the importance of ownership and control. To maintain control they might choose to start a new business in the foreign country as a **wholly owned greenfield site**. Alternatively they might buy an existing business with market presence in the country they wish to enter – this would be a **full acquisition**, giving better control, protection of know-how and ability to coordinate globally.

Less control and ownership comes from choosing a **newly created joint venture** with another business, to share costs, risks and profits, and gain access to the partner's knowledge, assets and market presence. **Partial acquisition** of another business will give less ownership and control, and the potential of conflicts with the co-owners, but is a means of gaining size, presence and existing know-how in the foreign market. These options and their advantages, disadvantages and risks are discussed in Willcocks (2021a) p.163. You are recommended to read the relevant section carefully.

What about 'born global' companies? Do they have to make different market entry decisions? These companies start with a major – even exclusive – focus on foreign markets rather than just their country of origin. Consider the Swedish 2008 start-up, Spotify, which provides a music streaming service. Initially rolled out in Sweden, Norway, Finland, France and Spain, by 2018 it had over 150 million active users monthly in 65 countries. It is worth reviewing its history and challenges (see Activity below). The approach of a born global firm, at least initially, tends to be what has been described as 'lean internationalisation'. This means running as much of the business as possible using information technology and the internet; focusing on smaller market segments; being lean on committing resources, widespread use of intermediaries. It is a different, very contemporary way of entering new foreign markets.

Activity

Read Willcocks (2021a) pp.159–65, section 6.2.

1. Tesco, the UK-based, grocery supermarket chain is described as a market-seeking business. Review its recent history and make notes on how it sought new markets.
2. What are the advantages and disadvantages of being a first mover in a new foreign market? Give an illustrative example.
3. What are the advantages and risks of being a follower into a new foreign market? Discuss McDonalds late entry into the Chinese market.
4. Read case study on 3D printing companies entering new markets (VLE Chapter 9).
    a. For start-ups developing 3D-printing technologies, what are the main challenges in developing a viable business model?
    b. How should such a company move into foreign markets? Why? Which markets? When? At what scale and level of ownership?
5. Read case study 'Spotify – going global, one song at a time' (VLE Chapter 9).
    a. Describe how Spotify expanded to a global presence.
    b. What challenges does a business like Spotify face when moving into new foreign markets?

9.3 Major modes of entering foreign markets

There are six major ways we see businesses entering foreign markets. Each mode of entry has its advantages and disadvantages. As a company's positioning in a foreign market evolves, you will also see shifts in ownership and modes of operating in order to achieve further revenue growth and competitive advantage.

9.3.1 Exporting

Exporting is the sale of products made by companies in their home country to customers in other countries. Exporting is a common first step for many manufacturing firms. Later, feeling limited in terms of revenue growth, and lack of control, such firms may switch to another mode. Exporting is attractive because:

- It avoids the costs of establishing local manufacturing and service operations.
- It helps firms achieve experience curve and location economies.
- Lack of trust on payment can be overcome by a letter of credit, working through the banks of the buyer and supplier.
- Export intermediaries are usually available in the exporting country with the expertise to help facilitate exports to a range of other countries. These are especially used by SMEs. The exporter can also employ its own sales agents, on commission fees, in the foreign country, or sell the products to a distributor, who is a local intermediary in the foreign country trading on their own account.

However, exporting might also be unattractive because:

- There may be lower-cost locations for manufacturing the products abroad that are not being taken advantage of.
- High transport costs and tariffs can make it uneconomical.
- Agents in a foreign country cannot be closely controlled.
- There may be restrictions on the amount of revenue growth that can be achieved.

9.3.2 Turnkey projects

In a turnkey project the foreign contractor agrees to handle every detail of the project for a local client, including training personnel. After designing and constructing the new facility, the contractor completes the contract by handing the client the 'key' to the plant that is ready for full operation – which gives it the term **turnkey**. A variant is the build–operate–transfer model, which includes the contractor managing the facility for fees after the construction has been completed. Turnkey projects are most common in the metal refining, pharmaceutical, petrol refining and chemical industries. All of these use complex and expensive production technologies. Turnkey projects are a means of exporting such know-how to foreign countries lacking these competencies. The approach is also popular in the construction and engineering industries for large infrastructure projects.

Turnkey projects are attractive because:

- They are a way of earning economic returns from the know-how required to assemble and run a technologically complex process.
- They can be less risky than more conventional forms of foreign direct investment.

However, problems with turnkey projects include:

- The contractor company has no long-term interest in the foreign country so market growth may be small.
- The contractor company may create a local competitor that can grow to compete globally.
- If the contractor company is supplying process technology or know-how that is its own source of competitive advantage, then selling this through a turnkey project is also selling competitive advantage to potential competitors.

Activity

A large infrastructure project may also be run by a consortium. A consortium is a project-based temporary business owned and managed jointly by several companies. In a major contract, there will also be numerous sub-contracting (i.e. handing over the management and completion of parts of the work to specialist companies with specific capabilities). The case study 'The Qatar-Bahrain causeway' (VLE Chapter 9), provides an example of a major infrastructure project with the Qatar-Bahrain bridge construction. Read this case and ask yourself:

1. Why was a consortium model adopted? Were there feasible alternatives?
2. What challenges are presented in managing and using such a model?

9.3.3 Licensing

A licensing agreement is where a licensor grants the rights to **intangible property** to another entity (the licensee) for a specified period in return for a royalty fee paid by the licensee. Intangible property includes patents, inventions, formulas, processes, designs, copyrights and trademarks.

Licensing has several advantages:

- It avoids development costs and risks associated with opening a foreign market.
- It avoids barriers to investment (e.g. in the case of US-based Xerox, the Japanese government prohibited Xerox from setting up a fully owned subsidiary in Japan).
- The company can capitalise on market opportunities without developing additional marketing, administrative and operational capabilities itself.

At the same time licensing may be unattractive because:

- The company does not have tight control over manufacturing, marketing and strategy needed to gain economies from experience curve and location advantages.
- For a technology-based company, lack of control over the technology and intellectual property (IP) may become a problem.
- The company's ability to coordinate strategic moves across countries is constrained.
- Proprietary or intangible assets could be lost.

9.3.4 Franchising

Franchising is a specialised, longer-term form of licensing where the franchiser not only sells intangible property to a franchisee (e.g. a trademark), but also insists on tight rules regarding how it does business. The franchiser will also often assist the franchisee to run the business on an ongoing basis. Typically the franchiser receives a royalty payment, usually a percentage of the franchisee's net revenues. Whereas licensing is used primarily by manufacturing firms, franchising is used primarily by service companies. The obvious example globally is McDonalds.

The advantages of franchising include:

- It avoids the costs and risks of opening up a foreign market.
- A company can quickly build a global presence.

However, a business needs to take into account certain risks of franchising, including:

- It may inhibit the company's ability to take profits out of one country to support competitive attacks in another.
- Geographical and administrative distance from the franchisee may make it difficult to detect poor quality.
- Poor quality at one branch can hurt the brand globally. For example, travellers expect the same quality of experience in a Four Seasons hotel in Hong Kong as in New York. If they experience variable quality they may be dissuaded from staying in this brand of hotel in the future.

Activity

Why does McDonald's, the multinational food chain, make such a large commitment to controlling and helping its franchisees?

9.3.5 Joint ventures

A joint venture (JV) involves establishing a company that is jointly owned by two or more otherwise independent companies. US multinational General Electric has in recent years used joint ventures to enter foreign markets like Spain and South Korea where its units lacked a strong presence. JVs are typically 50/50 owned by the partners, but minority ownership is also frequent, though this sometimes creates issues around power, direction and control.

Joint ventures can be attractive because:

- Companies benefit from a local partner's knowledge of local conditions, culture, language, political systems, legal know-how and business systems.
- The costs and risks of opening a foreign market are shared.
- JVs often satisfy local political considerations for market entry.

But joint ventures run a number of risks (discussed in more detail when we look at strategic alliances):

- The company risks giving control of its technology to its partner.
- The company may not have the tight control needed to realise economies from the experience curve or from location economies (see Chapter 7) or to coordinate attacks against rivals on a global basis.
- Shared ownership can frequently lead to conflicts and battles for control if goals and objectives differ or change over time, or power imbalances develop between the parties.
- JVs can be difficult to coordinate globally.

9.3.6 Fully owned subsidiaries

Here the company owns 100 per cent of shares in the subsidiary. A fully owned subsidiary can be defined as a subsidiary located in a foreign country that is entirely owned by the parent multinational.

Fully owned subsidiaries are attractive because:

- They reduce the risk of losing control over core competencies.
- The company gains 100 per cent of the profits earned in the foreign market.
- They can help in the protection of key technologies and intellectual property.
- They give tight control over operations in different countries, which is necessary for engaging in global strategic coordination.
- They may be required in order to gain location and experience curve economies. This is important where a company wishes to establish a fully optimised global production system, or where there are intense cost pressures in the specific industry, for example.
- Companies pursuing global standardisation or transnational strategies (see Chapter 7) tend to prefer establishing fully owned subsidiaries, which allow them more opportunity for creating an integrated global strategy.

Fully owned subsidiaries may also be unattractive, not least because the company bears the full risk and cost of setting up overseas.

One additional decision a company needs to make if going down the fully owned subsidiary route is whether to adopt a greenfield or acquisition strategy. In a greenfield strategy, the company builds the subsidiary from the ground up, as opposed to acquiring an existing company.

The main advantage of a greenfield venture is that it gives the company a greater ability to build the kind of subsidiary company it needs. Companies also often discover that it is very difficult to transfer organisational culture and ways of operating to acquired companies. A wholly owned greenfield venture also gives control over equity and operations, and better protects intellectual property. But greenfield ventures are slower to establish, and are also risky in terms of high capital investment and long payback periods. They might also lead to market entry being pre-empted by a rival who uses an acquisition strategy to gain a quicker foothold in the same market.

Alternatively, a company can acquire an established company in the host nation and use that company to promote, or even manufacture, its products/services. Acquisitions can be attractive as a mode of entry because:

- They can be quicker to execute.
- They enable companies to pre-empt their competitors in the foreign market.
- Part acquisition can still offer access to operations the previous owner resisted giving up, and also the previous owner's continuing commitment.
- They do not add unnecessary new capacity.
- They may incur less risk than greenfield ventures or other options. You buy a set of assets that are producing a known revenue and profit stream. You also gain tangible assets (factories, logistics systems,

etc.) as well as intangible assets (e.g. brand name, managers' local knowledge of markets, existing customer relationships).

However, acquisitions have been known to fail due to:

- The acquiring company overpaying for the acquired company
- High up-front capital needs
- Clash of cultures between the two companies
- Political sensitivities in the host country
- Attempts to realise synergies running into roadblocks, for example incompatible technologies and human resource policies, and so taking much longer and being more expensive to realise than forecast.
- There is inadequate pre-acquisition screening.

For these reasons companies that are frequently on the acquisition trail, for example Cisco Systems and Cemex, develop a core expertise in carefully screening the company to be acquired, ensuring they do not pay too much for the acquisition, and moving rapidly to implement a pre-developed integration plan. Another approach to reduce risks might be to carry out staged acquisitions, though this can create uncertainty about the future ownership structure.

Activity

Read Willcocks (20121a) Chapter 6 section 6.5, pp.175–77, on fully-owned subsidiaries, and mergers and acquisitions. Then consider the case study: 'Thai Union: expansion by acquisition' (VLE Chapter 9) and answer the following questions:

1. What are the key resources and capabilities that have enabled Thai Union to enter markets in Europe and the USA?
2. Why has Thai Union chosen acquisition as the route to entering foreign markets? What challenges has it experienced?
3. What would your design be for Thai Union's strategy for the China market? What challenges do you foresee? Who would be an appropriate partner, and what organizational form would you recommend?

9.4 Assessing the relevance of strategic alliances

Strategic alliances (SAs) are collaborations between independent companies using equity modes, non-equity contractual agreements or both. SAs can form between potential or actual competitors (see the discussion on complementors in Chapter 8). Formal joint ventures are one form of strategic alliance. But an SA may also take the form of business unit joint ventures, R&D joint ventures, or short-term contractual agreements to cooperate on a particular strategic task, for example joint marketing, production or distribution arrangements. Why choose a strategic alliance?

- It facilitates entry into a foreign market.
- It can be a stepping-stone to a full acquisition, allowing the parties to learn how to work together, so smoothing the path to full acquisition.
- It allows a company to share the fixed costs and risks of developing new products or processes.
- It helps a company to establish technological standards for the industry that will benefit both companies.
- It brings together complementary skills and assets that neither partner could easily develop on its own.

However, SAs have been criticised as an entry mode because:

- An SA may give the competitor you ally with a low-cost route to technologies and market. For example, many US companies in the semiconductor and machine tool industries were criticised for their SAs with Japanese companies which, it was argued, allowed the Japanese companies to keep high paying, high value added jobs in Japan while gaining valuable US project engineering and production process skills, thus reducing US companies' competitive advantage.
- The failure rate for SAs is very high. Historically, two-thirds run into serious financial and managerial trouble within two years of their formation, and one third of these are subsequently rated as failures.

This suggests that SAs need to be carefully entered into and managed. One approach is to look for a limited SA first. Thus some companies enter into a business unit JV, where existing business units from two companies are merged. This works if the two companies can achieve something (e.g. market leadership or technological innovation) that neither could achieve on their own. It may also be a sensible option if a full takeover is not practicable, or where the merged unit depends on inputs such as technologies from both parties that would be disrupted by legal separation. Another form of SA is operational collaboration, consisting of collaboration in operations, marketing or distribution. For example, in the airline industry, national airlines form alliances to connect to all major travel destinations, and also share frequent flyer programmes and facilities and resources such as passenger lounges.

The success of an alliance is a function of:

- **Partner selection**: An effective partner helps the company achieve its strategic goals and has capabilities the company lacks, it has a shared vision on the alliance's purpose and does not exploit the alliance just for its own ends.
- **Alliance structure**: This should make it difficult to transfer technology that is not meant to be transferred; have contractual guarantees to guard against partner opportunism; and allow for swapping of skills and technologies with equal gains.
- **Management capability**: This requires the building of strong interpersonal relationships – called relational or social capital – between the two managements. It also seems to require learning from each alliance partner.

Activity

1. Read Willcocks (2021a) Chapter 6, section 6.6, pp.178–80, section 6.6 and pp.174–75 on joint ventures.
   a. Make a note of some successful business unit and R&D joint ventures.
   b. Why embark on a strategic alliance?
   c. What are the major challenges in trying to get a strategic alliance to work?
   d. How can a strategic alliance be set up and managed effectively?
2. Using a search engine, such as Google, find a major strategic alliance and examine its history. Ask yourself:
   a. Why did the parties choose to enter this strategic alliance? Were there better alternatives?
   b. What levels of success have been achieved?
   c. What explains the results the strategic alliance has been getting?
   d. Do you see a further evolution of their international business strategies by the two parties? In what directions?

9.5 Going international: growth through evolution

It is important to understand that foreign market entry is only the start of what is often a very long journey for a company. If you refer back to Chapter 7, you will recall how a company will seek to evolve and grow its international business. An international strategy will seek to sell domestic products in foreign markets with minimal customisation. Or a company may choose a localisation strategy to give itself a competitive edge in the foreign market. However, pressures to reduce costs together with the requirement to grow market size may well lead to the development of a global standardisation strategy. Alternatively, where there are pressures to reduce costs, retain local responsiveness and grow the market globally, the company may well move to a transnational strategy.

In Chapter 8 we saw that competitive markets are highly dynamic and companies are continually seeking to match, outpace or respond to competitors, these days increasingly on a global stage. In Chapter 11 we will see how companies continually have to adjust their organisation structures to fit with their emerging strategies to expand operations, revenues and profits, and adjust to changes in location and market attractiveness.

All this means that the initial mode of entry may well be only the temporary starting point for a company's globalising strategy. A company can make a relatively low commitment to a market through exporting, licensing and franchising, or by small-scale or partial acquisitions, or by limited joint ventures/alliances. As Willcocks (2021a) points out, they may also seek a low-risk approach such as using the Internet to extend their business beyond national boundaries. However, to grow further they may need to make bigger commitments through fully owned subsidiaries, large-scale joint ventures and/or large mergers/acquisitions. In doing so, they will need to integrate their internet business strategy relative to their other modes of operating in foreign markets.

By way of summary, Willcocks (2021a) Chapter 6, p.181, figure 6.4 provides a useful overview of major, typical modes of market entry, and their attributes in terms of control, resource commitment, strategic flexibility and levels of risk.

Activity

Now read Willcocks (2021a) Chapter 6 to consolidate your learning, noting additional points and illustrative cases. Note in particular sections 6.3 and 6.4 as revision of the ideas in Chapter 4 of this subject guide.

Ask yourself:

1. Why do companies engage in foreign direct investment?
2. What are the advantages and drawbacks of MNE foreign direct investment to the host country?

9.6 Key concepts

The key concepts in this chapter are:

- natural resource-seeking
- market-seeking
- efficiency-seeking
- innovation-seeking
- greenfield site versus full acquisition
- exporting
- turnkey projects
- licensing
- franchising
- joint ventures
- fully owned subsidiaries
- first mover versus late entrant advantage
- strategic alliances
- growth through evolution.

9.7 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- explain the four decisions a company must address when entering foreign markets: why enter a foreign market, which market(s) to enter, when to enter the market(s) and on what scale and level of ownership
- describe the advantages and disadvantages of the major ways that small and medium enterprises (SMEs) and multinational enterprises (MNEs) can enter foreign markets
- identify the key factors that shape a company's choice of entry mode
- discuss the advantages of acquisitions versus greenfield ventures as entry strategies
- explain why companies enter into strategic alliances and the factors that can make such an entry mode effective or ineffective
- determine how individual companies evolve and expand their international presence.

9.8 Test your knowledge and understanding

Read the case study Chapter 9 'The Jollibee phenomenon' (VLE Chapter 9) and answer the following questions:

1. How did Jollibee decide to compete with McDonalds and others domestically and globally?
2. Give examples of the factors it took into account in order to enter new markets.
3. Why has the company been successful in the USA?

9.9 Sample examination question

It is very important for a business to consider why and when to enter new markets effectively. Therefore:

a. Assess the factors a business would need to consider when deciding whether to enter a foreign country market, which market to enter, when to enter, and the scale and ownership required. Use examples to illustrate your points.

b. What is a strategic alliance? Using examples, assess its advantages and risks as a mode of foreign market entry for the internationalising business.

c. When are fully owned subsidiaries an attractive market entry mode? When are they less attractive?

d. Describe what a turnkey project is, and the conditions under which it is an attractive mode of entering a foreign market. What potential problems make a turnkey project approach less attractive?

Notes

Chapter 10: International marketing and R&D strategy

10.1 Introduction

This chapter covers international marketing strategy, market segmentation and the '4Ps' mix of product, price, promotion and place. Marketing strategy leads to a focus on new product and market development, R&D and R&D offshoring, as well as distribution channels (place). The 2020–21 pandemic and economic crises brought to the fore the relevance of marketing strategies using content to create powerful online connections. However, this has been a long-term trend, with the 2020–21 experiences accelerating these developments, and providing many useful marketing lessons across economic sectors.

Marketing is 'the activity, set of institutions and processes for creating, communicating, delivering and exchanging offerings that have value for customers, clients, partners and society at large' (AMA, 2007). Business to consumer marketing is the process by which companies create value for customers and build strong customer relationships in order to capture value from customers in return. Business-to-business marketing creates value, solutions and relationships either short term or long term with another company or brand.

International marketing refers to marketing carried out by companies overseas or across national borderlines. Company-level marketing practices across borders include market identification and targeting; strategic decisions to compete in international markets; entry mode selection; and marketing mix choices. Marketing is not just about gaining pro le for the existing products and services, but connects also to product/service development and innovation – the field of Research and Development (R&D).

10.1.1 Aims of the chapter

The aims of this chapter are to:

- establish definitions and understanding of the concepts of marketing strategy, market segmentation and the marketing mix of the 4Ps
- identify the range of approaches possible for product, price, promotion and place strategies
- relate supply chain management to place strategies and show how firms achieve distribution and logistics
- introduce research and development activities and the criteria by which a firm locates such activities internationally.

10.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define and apply marketing strategy, segmentation and marketing mix concepts to real-life examples in international business
- discuss product, price and promotion strategies and assess how they can be shaped to specific country conditions
- articulate and apply major concepts in distribution strategy and supply chain management

- discuss the main issues that make R&D important, that make its foreign location both attractive and challenging, and where to locate R&D.

10.1.3 Essential reading

Willcocks, L. *Global business: management.* (Stratford-upon-Avon: SB Publishing, 2021b) Chapter 3.

10.1.4 Further reading

Hill, C. *International business: competing in the global marketplace*. (New York: McGraw Hill, 2021) 13th edition, Chapter 18 'Global marketing and business analytics'.

Whittington, R., P. Regne, K. Scholes, D. Angwin and G. Johnson, *Exploring strategy*. (London: Pearson, 2019) 12th edition.

Peng, M. and K. Meyer, *International business*. (London: Cengage Learning, 2019) Chapter 17, pp.471–92.

10.1.5 References cited

'Definitions of marketing', American Marketing Association, 2007. Available at: www.ama.org/the-definition-of-marketing-what-is-marketing/

Ansoff, H. *Corporate strategy*. (London: Penguin, 1988).

10.1.6 Synopsis of chapter content

Defining market strategy, segmentation, and the four elements of the marketing mix – price, promotion, place and product; product, price, promotion and distribution strategies; strategies for research and development (R&D).

10.2 Marketing strategy and the marketing mix

Are markets and brands becoming global? Can a company sell the same product the same way everywhere? Probably not – especially with consumer products. For example, just looking at major US brands, while McDonald's is available around the globe, the company does make menu changes from country to country (e.g. a McArabia in the Middle East and a Croque McDo in France).

McDonald's also changes its distribution strategy. As we saw in earlier chapters, although the world is moving towards global markets, cultural and economic differences continue to exist among nations (see Chapters 2, 3 and 7), so therefore any trend towards global consumer tastes and preferences is limited.

International marketing strategy must be consistent with the company's corporate and business strategies. Marketing strategy focuses on choices over products/services and markets. The Ansoff matrix (Ansoff, 1988) helps us here and suggests four strategic choices (see Willcocks, 2021b, p.57, figure 3.1):

- **Market penetration strategy**: This involves increasing the share of current markets with the current product/service range. We know that companies go international because this strategy often does not meet its growth needs domestically in limited or overcrowded markets or where products are mature.
- **Market development strategy**: Selling existing products in new markets. This strategy can see companies marketing abroad to new markets to extend the life of their products and find opportunities to grow revenues and profits. This may also entail some product

development (e.g. new styling or packaging). It can take the form of attracting new users (e.g. extending the use of aluminium to the automobile industry) or the form of new geographies (e.g. extending the market covered to new areas – international markets being the most important).

- **Product development strategy**: New products in existing markets – this involves varying degrees of related diversification (in terms of products). The strategy can be expensive in terms of R&D and marketing, may require new strategic capabilities and typically involves project management risks.
- **Diversification strategy**: New products in new markets. This strategy is the riskiest approach to internationalisation. According to Whittington et al. (2019) the main drivers for diversification are exploiting economies of scope – efficiency gains through applying the organisation's existing resources or competences to new markets or services; stretching corporate management competences, exploiting superior internal processes and increasing market power.

The **marketing mix** (the choices the company offers to its targeted market) is comprised of the '4Ps':

1. product attributes
2. pricing strategy
3. promotion (i.e. communication strategy)
4. place (i.e. distribution strategy).

Companies have to decide which elements of the marketing mix can be standardised, and which need to be adapted to the local market. How do you figure this out? You can start by segmenting markets.

Market segmentation involves identifying distinct groups of consumers whose purchasing behaviour differs from others in important ways. You can segment markets in many ways, for example by sex, age, income level, education level. Typical criteria for segmentation into customer groups are by:

- geography
- demography
- socio-cultural factors
- psychological factors.

Look at Willcocks (2021b) p.59, figure 3.2. Here you can see how, on a bigger view of international differences (see CAGE in Chapter 7), environmental variables help in the process of identifying the customer market segments your company wishes to target. The figure in Willcocks (2021b) shows the four CAGE factors and the four marketing management variables – product, place, promotion and price – as a basis for market segmentation.

Once you have identified different segments, you can adjust the marketing mix accordingly. Toyota, for example, sells its Lexus line to high-income consumers, but attracts lower-income buyers with its Corolla. Companies not only need to adjust their marketing mix from segment to segment, they also need to identify segments that transcend national borders and understand differences across countries in how the segments are structured.

Two key international market segmentation issues are the differences between countries in the structure of market segments and the existence of segments that transcend national borders. When segments transcend national borders, a global strategy is possible. Remember also that global market segments are more likely to exist in industrial products than in consumer products.

At this stage, refer to Willcocks (2021b) p.61, figure 3.3. This gives you an overview of the whole marketing strategy process and brings together the range of factors and issues that need to be considered.

Activity

Read the case study: 'Levi Strauss goes local' (VLE Chapter 10). Think hard about how Levi Strauss markets its products globally and look at how it markets and distributes products in your own country. Identify its decisions on:

1. target markets and market segmentation
2. product/market strategy
3. the marketing mix – the relationships between products, place, promotion and pricing approaches.

Then answer these questions:

1. Has Levi Strauss's approach in your country changed in the last five years? How and why?
2. How competitive would you judge Levi Strauss as being in your country?
3. What do you think the company should do on marketing, following the 2020–21 crisis?

10.3 Marketing across the consumer life cycle

Engaging your customers is crucial to achieving continued sales. It is also usually far easier, and costs much less, to get repeat business from existing customers than it is to acquire new ones. Customer relationship management (CRM) is well established as a process to try to achieve this. The core CRM tasks are customer acquisition, retention and development. The 'relationship' begins with the very first contact with the customer when they are simply a contact or prospect, and continues across an engagement life cycle where the repurchase decision becomes the key to success. But this only happens with careful marketing and management of the customer experience. Look now at Willcocks (2021b) p.62, figure 3.4. This shows the five stages of attending to customer needs and building a relationship with customers in order to get them to buy further goods and services from your business. The stages are:

1. awareness
2. evaluation
3. purchase
4. product and support experience
5. bonding.

The benefits from strong customer relationships are many, and include:

- increasing purchases from the same customers
- customer referrals to potential customers
- potential for premium pricing
- easier selling of new products and services, based on customer confidence
- understanding the customer, so being able to meet and exceed their expectations, develop more customer-focused products and services, and identifying quality, pricing and service required.

Activity

It's a good time to review where we have got to with this subject of marketing! Read Willcocks (2021b) Chapter 3, pp.54–67, then answer the following:

1. Make notes on your understanding of the following terms: marketing, marketing strategy, marketing mix, market segmentation.
2. Remind yourself of the five stage of customer life cycle marketing, and the benefits, and expenses avoided, by marketing across the customer life cycle.
3. Think of your local coffee shop, or grocery shop or supermarket. How good are they at 'seeing the business through the customer's eyes' and putting the principles outlined here into practice?

10.4 Product

Let us look at each element in the marketing mix, beginning with product. A product is a bundle of attributes. Stop there and think. What attributes does a product actually have that you find attractive? Take, for example, a car. You might be buying its **content**, that is its superior performance and technical, aesthetic physical features. You might be buying the **aura** – what the car 'says' about you as a symbol of status and taste. You might be buying **support** aspects – for example the expertise that surrounds a luxury BMW or a high degree of **service** personalisation that used to surround a Rolls Royce. A 'product' is actually more complex than you first think. For example, if you buy an electronic dishwasher, what sort of warranty – insurance of performance for a defined time period – would you prefer? Clearly there are many ways to differentiate a product, even a humble product like a potato, for example.

This discussion on product differentiation should remind you of the earlier section on broader differentiation strategy, in Chapter 8 of this guide. Recall from there that a business needs to decide: are our customers wanting to buy content, aura, support or service, or perhaps some mix of some or all of these?

Products sell well when their attributes match consumer needs. If consumer needs were the same everywhere, a company could sell the same product everywhere. In international business another factor comes into play. What do you do when consumer needs vary from country to country? Clearly there is plenty of room for product differentiation, but let us explore three international dimensions a little more.

- **Cultural differences**: What are the cultural differences between countries? Countries differ across a range of cultural dimensions including tradition, social structure, language, religion and education (see Chapter 3). To identify where standardisation is possible and where the marketing mix must be customised, companies need to look for evidence in the selected marketplace. Nestlé, for example, sells frozen food in multiple countries, but offers different menus depending on local preferences. Nestlé sells fish fingers in the UK, but coq au vin in France, yet it is able to sell lean cuisine dinners in the same way in both Europe and the USA. Coca-Cola builds on its brand name in Japan by offering a tonic drink that appeals to local consumers in addition to its traditional cola.
- **Level of economic development**: Companies that are based in highly-developed countries tend to build lots of performance features into their products. Think about your car for example. Do

you have power steering and power windows, maybe a CD player or DVD player? In contrast, we know that consumers in less developed countries tend to prefer more basic products, but want high product reliability. But even this will not be true of every market segment. Think of India and China. How easy is it to generalise across whole countries and billions of people? Marketing is more complicated than you think.

- **Product and technological standards**: Sometimes companies have to customise their marketing mix to meet national differences in product and technological standards. For example, differences in technical standards between the UK and the USA mean that producers of DVD equipment have had to adapt their product to each market.

Activity

Look at Willcocks (2021b) pp.67–69, section 3.4 on product. Now answer the following questions:

1. Take a local beer (e.g. Tiger beer in Singapore, Cobra beer as an Indian product or Singa beer from Thailand). Find out how the beer you have selected is marketed. What are the attributes of the product, what is the market segment, what is the message of the brand?
2. Now repeat the exercise for the marketing of beer in another country with which you are familiar. Note and give reasons for the marketing differences and the similarities.
3. Look at the Netflix example (Willcocks, 2021b, p.67). Explain how Netflix achieves effective product differentiation.

10.5 Pricing strategy

Microeconomics, managerial economics and industrial economics are the fields which cover in detail (among other things and from different perspectives) how pricing relates to the structure of demand, technology and competition in the industry. This course does not require a detailed understanding of economic theories, only an understanding of price from a marketing perspective. So how should a company price its product in foreign markets? Should prices be different in different markets? Are there any regulations that might influence how a product should be priced?

A company can maximise its profits by using **price discrimination** where consumers in different countries are charged different prices for the same product. In other words, the company charges whatever the market will bear. For price discrimination to work, the company has to be able to keep its national markets separate. In other words, the car manufacturer might not be able to price the cars differently in, say, France and Germany, but it could charge a higher price in France and Germany than the price charged in the UK because right-hand drive cars are sold in the UK, while left-hand drive cars are sold in both France and Germany.

Companies can also use price discrimination when different price elasticities of demand exist in different countries. Demand is elastic when a small change in price produces a large change in demand. Demand is inelastic when a large change in price produces only a small change in demand. In 2007, international company Tommy Hilfiger, for example, successfully priced its jeans in Europe at roughly three times the price of its jeans in North America.

In general, companies can charge higher prices when demand is inelastic. What determines elasticity of demand? Income level is one factor. When income levels are low, people tend to be more price conscious and demand is more elastic. In parts of India, for example, products like TVs that are considered necessities in the USA are still thought of as luxury items. The other main factor that affects price elasticity is the number of competitors in a market. The more competitors, the greater the bargaining power of consumers is and the greater the elasticity of demand.

What about strategic pricing? Companies can set prices to achieve certain strategic goals. There are three aspects of strategic pricing:

- **Predatory pricing** involves using profits earned in one country to support aggressive pricing in another market as part of a strategy to drive out competitors in that market. Once the competition leaves, the company then raises its prices. Matsushita in the 1980s allegedly used this type of strategy to gain market share in the USA. Note that some types of predatory pricing are illegal in some countries.
- **Multipoint pricing** refers to the fact that a company's pricing strategy in one market may have an impact on how a rival prices products in another market. For example, if a company uses aggressive pricing in one market, its rival may resort to aggressive pricing in another market.
- **Experience curve pricing**. Here a company will set low prices worldwide as a way of quickly building sales volume. Companies using this type of strategy are willing to take a loss initially because they believe that in the future, once they have moved down the experience curve, they will have a cost advantage over less aggressive competitors. Recall from Chapter 7 that companies further along the experience curve have a cost advantage relative to companies further up the curve.

As we mentioned earlier, sometimes companies have limits on how they can price their products because of regulations in the target market. So, a company that wants to use a price discrimination strategy or multipoint pricing, for example, may find that it cannot. Two ways in which a company's ability to set its own prices can be limited are through anti-dumping regulations and through competition policy – see Chapters 4 and 5, above. Both predatory pricing and experience curve pricing can be problematic when anti-dumping regulations are in place. Many countries also have policies in place that are designed to promote competition and restrict monopoly practices. As with anti-dumping regulations, competition policies can limit the prices companies can charge for their products.

Activity

Read Willcocks (2021b) section 3.5 on price.

1. Explain price discrimination, and the conditions under which it works in international business.
2. Why are some consumers willing to pay $300 for a tennis racket, while others will only pay $100 for a racket that seems very similar in terms of performance? What do you think justifies the $200 price difference? Look at section 10.4 Product, above, for some clues here!
3. How price elastic is the market for shampoo in your country? How does this compare in a poorer country? A more affluent country?

10.6 Promotion strategy

The next element in the marketing mix is promotion (i.e. communication strategy). Promotion includes TV, radio, print, online advertising, personal selling, social media, direct mail, public relations, coupons, billboards, etc. A vital question is: which of these methods is best used to communicate with the target market you are interested in? A second vital question is: what are the limits of standardised messages and promotion methods? Once again we come up against the issue of differences between different types of consumer. When you add in country differences, then you begin to see the limits to mass media, branding and standardised messages. International communication is not always easy. All too many things can get in the way of the message. Let's look at just three important examples:

- **Cultural barriers**: The effectiveness of a company's international communication can be jeopardised by cultural barriers – it can be difficult to communicate messages across cultures. A message that means one thing in one country may mean something quite different in another. Such barriers can prevent a company from using a successful advertising campaign across countries. Companies can get around some of these problems by developing cross-cultural literacy, hiring a local advertising agency and using a local sales force where possible. See Willcocks (2021b) Chapter 3, pp.71–72, section 3.6 for examples of the problems Proctor and Gamble experienced in different markets.
- **Source and country-of-origin effects**: Source effects occur when the receiver of the message evaluates the message on the basis of status or image of the sender. You can counter negative source effects by de-emphasising their foreign origins. Country-of-origin effects refer to the extent to which the place of manufacturing influences a customer's product evaluations. BP, for example, changed its name from British Petroleum after it made a big push into the USA so that customers would not think about the fact that one of the biggest gasoline companies in the USA is from the UK.
- **Noise levels** refer to the number of other messages competing for a potential consumer's attention. The USA, for example, has a higher level of promotional noise than most other developed economies. As a generalisation only, noise tends to be higher in developed countries like the USA, Singapore or Germany than in emerging markets.

When a company chooses its communication strategy, it has to decide between a **push strategy**, which emphasises personal selling, and a **pull strategy**, which uses mass media advertising. Which strategy is best? The choice between strategies depends on:

- **Product type and consumer sophistication**: A pull strategy works well for companies in consumer goods selling to a large market segment. A push strategy works well for industrial products.
- **Channel length**: A pull strategy works better with longer distribution channels.
- **Media availability**: A pull strategy relies on access to advertising media. A push strategy may be better when media is not easily available.

Sometimes, companies find that they do not have a real choice between a push strategy and a pull strategy. A pull strategy relies on advertising media like TV, newspapers, magazines and so on. If these are not readily available, then a pull strategy will not work and companies will have to use a push strategy. So, a push strategy will be best when the company is selling industrial products or complex new products, when distribution channels are short and when few print or electronic media are available, while a pull strategy will make sense for consumer products, when distribution channels are long and when there are sufficient print and electronic media available to carry the marketing message.

Standardised advertising makes sense when:

- It has significant economic advantages.
- Creative talent is scarce and one large effort to develop a campaign will be more successful than numerous smaller efforts.
- Brand names are global.

Standardised advertising does not make sense when:

- Cultural differences among nations are significant.
- Advertising regulations limit standardised advertising.

Some companies, then, will standardise parts of a campaign to capture the benefits of global standardisation, but customise others to respond to local cultural and legal environments.

Activity

Read Willcocks (2021b) section 3.5 on price.

1. Explain price discrimination, and the conditions under which it works in international business
2. Why are some consumers willing to pay $300 for a tennis racket, while others will only pay $100 for a racket that seems very similar in terms of performance? What do you think justifies the $200 price difference? Look at section 10.4 Product, above, for some clues here!
3. How price elastic is the market for shampoo in your country? How does this compare in a poorer country? A more affluent country?
4. C&A want advice on using Second Life or Facebook for marketing purposes. What advice would you give?

10.7 Place: distribution strategy

Place refers to where a product or service is provided. These days, of course, this does not have to be a physical location, but could be virtually, over the internet (e.g. software and movie downloads). How a company delivers its product to the consumer is a critical element of the marketing mix.

Companies can sell directly to consumers, to retailers, or to wholesalers, regardless of where the product is produced. Distribution strategy refers to the means the company chooses for delivering the product to the consumer. How a product is delivered depends on the company's market entry strategy. For example, companies that manufacturer the product locally can sell directly to the consumer, to the retailer or to the wholesaler. Companies that manufacture outside the country have the same options plus the option of selling to an import agent.

In international business, Hill (2021) points out that there are at least four main differences in distribution systems you need to bear in mind:

- **Retail concentration**: A country's distribution system can be very concentrated where a few retailers supply most of the market, or very fragmented where there are many retailers, none of which has a significant share of the market. In a concentrated retail system, a few retailers supply most of the market. In a fragmented retail system there are many retailers, no one of which has a major share of the market – very common in developing countries. The UK is an example of a country with a concentrated retail system. In contrast, Japan has a more fragmented system where stores serve the local neighbourhood. Usually, we think of greater retail concentration as being associated with developed countries because people have cars to drive to the stores, own large refrigerators to store food in, and many two-income households. However, we are seeing some concentration in developing countries too.

- **Channel length**: The number of intermediaries between the producer and the consumer. A short channel, when the producer sells directly to the consumer, is common with concentrated systems. A long channel, when the producer sells through an import agent, a wholesaler, and a retailer, is common with fragmented retail systems. Japan is often associated with long channels. Countries like Germany and the USA tend to have much shorter channels.
- **Channel exclusivity**: Sometimes companies have a hard time breaking into new markets because they cannot access the distribution system. Sometimes channels are exclusive because retailers like to carry well-established brands rather than take a chance on something new. You probably see examples of this at your local grocery store.
- **Channel quality**: This relates to the expertise, competencies and skills of established retailers in a country and their ability to sell and support a foreign company's products. In general, channel quality in developed countries is better than in emerging or developing economies, but even in developed countries problems can prompt companies to develop their own channels. Apple, for example, has in recent years opened its own retail stores in countries like the UK to sell its iPods. The company believes that product knowledge is essential to its success and feels that relying on an outside company could be detrimental to its sales.

How to choose a distribution strategy? When price is important, a shorter channel is better, because each intermediary in a channel adds its own mark-up to the products. When the retail sector is very fragmented, a long channel can be beneficial because this economises on selling costs and can offer access to exclusive channels. In addition, if there are concerns about channel quality, companies should handle distribution on their own, like Apple did.

Activity

Read the Chapter 10 case study: 'Zara, marketing and distribution' (VLE Chapter 10). Then answer the following questions:

1. How does Zara organise its inbound and outbound logistics?
2. How did Zara disobey the normal rules of marketing and supply chain management in the fashion chain industry?
3. What explains Zara's success here up to end of 2019?
4. Check online how Zara now manages its supply chain and distribution. What explains Zara's approach?

10.8 Research and development (R&D) strategy

In 10.2 above, we talked about basing the company's product development or diversification strategy around product innovation. How does the globalisation of the world economy affect how new products are developed? First, remember that when we are talking about R&D, we are talking about the new product ideas that come from the interactions of scientific research, demand conditions and competitive conditions. You can probably think of many successful innovations that you use every day, for example iPods, 3M sticky note pads and Internet routers. Today, competition is as much about technological innovation as anything else. The pace of technological change is faster than ever and product life cycles are often very short. New innovations can make existing products obsolete, but at the same time, open the door to a host of new opportunities.

The value of R&D and the level of competitiveness in this business area were vividly demonstrated with the race to find an effective COVID-19 vaccine throughout 2020. As a result R&D processes were accelerated and a 90 per cent effective vaccine was declared in November 2020, with several other contenders also becoming available in early 2021. R&D investment has been growing at about four per cent per annum for the last 10 years – this is equivalent to two per cent of global GDP. Several industries like the hi-tech, automotive and consumer sectors put more than 20 per cent of revenues back into innovation. But to pay off R&D activity has to be aligned very closely with international business strategy.

Where should a company locate its R&D? In practice R&D is located in relatively few countries. New product development tends to occur more often in countries where more money is spent on basic and applied R&D, where demand for new products is strong, where consumers are affluent and where competition is intense. You will probably recognise that all of these conditions are present in the USA. Indeed, for most of the time after the Second World War, the USA was the leader in new product development and therefore the location of most R&D centres. However, over the last 20 years or so, things have been changing. The USA is still a leader, but companies from Asia and Europe have also become strong players. Japan, for example, is the leader for video games and Europe leads when it comes to wireless telecommunications.

In recent years China has been increasing its R&D expenditure relative to other countries; one can especially highlight the focus on automation and artificial intelligence (AI), with China seeking to become world leader in these over the next decade. But despite stagnation in overall R&D intensity, the last few years have seen greater emphasis on performing R&D abroad, and broadening R&D scope beyond the traditional concern to adapt technologies and products from home for foreign markets. So today, rather than simply relegating R&D to the USA, successful companies see new product development opportunities in multiple locations.

However, just because a company has a new product with many new features does not mean it will automatically be a commercial success. In fact, studies show that only 10–20 of new products ever have commercial success. Commercialisation of new technologies is very costly and can mean that a company has to produce multiple versions of a product to meet the needs of individual markets. Since new product development has a high failure rate, new product development efforts should involve close coordination between R&D, marketing and production. Integration will ensure that:

- Customer needs drive product development.
- New products are designed for ease of manufacture.
- Development costs are kept in check.
- Time to market is minimised.

Some companies achieve this type of integration by developing cross-functional teams that are led by credible, experienced project managers that have significant status in the company. To be effective, teams should also have members from all of the critical functional areas, be located so that members can be together, develop clear goals and establish an effective conflict resolution process.

To commercialise new technologies successfully, companies may need to develop different versions for different countries, so a company may need R&D centres in North America, Asia and Europe that are closely linked by formal and informal integrating mechanisms with marketing operations in each country in their regions, and with the various manufacturing facilities. Companies that want to build successful global R&D capabilities need to be sure that R&D, marketing and production are integrated.

Keep in mind that for an international company this might mean that the company has to develop a global network of R&D centres that are linked by formal and informal mechanisms. Hewlett Packard, for example, has four R&D centres, one in the USA, one in the UK, one in Israel and one in Japan. Similarly, Microsoft has R&D sites in Washington, California, Tokyo and Cambridge, England. Companies are attracted to locate in innovation hubs that cluster skills, funding and know-how. These occur around the world (e.g. Silicon Valley in the USA; Singapore; Cambridge, England; and Kobe in Japan).

How to protect intellectual property (IP) that results from international R&D activities? Willcocks (2021b) p.78, section 3.7 suggests several approaches:

- place R&D activities at home, or where a country offers strong protection
- change versions frequently
- build complexity into the product
- maintain high confidentiality and security
- support public policy initiatives to protect IP.

Activity

1. Read Willcocks (2021b) Chapter 3 pp.75–80, section 3.7.and answer the following questions:
   a. What challenges do R&D functions face today?
   b. What are the ways forward for R&D functions?
2. Read the case study: 'Li and Fung: from trading to supply chain management' (VLE Chapter 10).
   a. From a VRIO resource-based perspective, what distinguishes the company from buyers, suppliers and other intermediaries?
   b. Why do buyers and suppliers trade through Li and Fung, even though it costs money? Why not trade directly?
   c. Why was Li and Fung able to emerge stronger from the 2008–09 global economic crisis?
   d. Check online – did Li and Fung emerge stronger from the 2020–21 crisis?

Activity

Now read Willcocks (2021b) Chapter 3 to consolidate your learning, noting additional points and illustrative cases.

10.9 Key concepts

The key concepts in this chapter are:

- the marketing mix and the 4Ps
- market segmentation
- product
- price
- promotion
- place
- supply chain management
- research and development (R&D).

10.10 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define and apply marketing strategy, segmentation and marketing mix concepts to real-life examples in international business
- discuss product, price and promotion strategies and assess how they can be shaped to specific country conditions
- articulate and apply major concepts in distribution strategy and supply chain management
- discuss the main issues that make R&D important, and that make its foreign location both attractive and challenging.

10.11 Test your knowledge and understanding

Canada has an official animal (the beaver). So does Australia (the kangaroo). Does your country have an official animal? If you were hired to advise your country on how to market an animal to represent your country, what animal would you choose and how best would you market your country using the animal?

10.12 Sample examination question

- 'Marketing is commonly regarded as just 'getting the message out' and 'influencing customers'. But these days marketing has to be very closely related to research and development (R&D).'

Discuss this statement as follows:

a. Explain what the marketing mix is and how R&D can underpin the '4Ps' decisions of an international business. Use examples to illustrate which topics need to be researched. (12 marks)

b. What factors should an international firm consider when locating its R&D facilities? (6 marks)

c. What are the main international marketing strategies, and what R&D needs to be undertaken to support each strategy? (7 marks)

Notes

Part 4: International business management

Notes

Chapter 11: The organisation of international business

11.1 Introduction

Organisation structure is the formal division of the organisation into sub-units such as product divisions, national operations or functions (e.g. human resources, information technology, marketing). It is also about the location of decision-making responsibilities within that structure. Structure also refers to the establishment of integrating mechanisms to coordinate the activities of sub-units. These may be formal integrating mechanisms, for example the organisation structure itself including reporting lines and role assignment, and also cross-functional teams, pan-regional committees, etc. Peng and Meyer (2019) Chapter 15 also make a strong case for knowledge being a strong, more informal integrating force in an international business.

In this chapter we first discuss the advantages of centralised versus decentralised structures. We then revisit Chapter 7, and the issue of strategic alignment, to give an overview of how strategy must shape structure. We then describe four types of organisation structure commonly used in internationalising companies, and when these structures are most suitably deployed. We point out that in the modern global environment most organisations tend to use variants and parts of these structure types to customise their structure to support strategy in specific circumstances.

The bigger the global commitment of the company, the more coordination problems arise, thus requiring the development of integrating mechanisms, including the skilled management of knowledge. Managers must also be constantly aware of the need to fit environment to strategy to structure and other components of what we call organisation architecture – control systems, incentive systems, processes, organisational culture and people.

11.1.1 Aims of the chapter

The aims of this chapter are to:

- establish the important relationships between environment, strategy, structure and their joint evolution for firms operating internationally
- introduce the four types of structure international division, geographic area, global product division and global matrix structure
- demonstrate how a firm operating internationally needs to fit its structure to its international business strategy in order to optimise business performance
- establish the importance of integrating mechanisms in international business strategy, and the role of knowledge management in achieving integration
- identify the components of organisational architecture and the concept of 'fit' with strategy and structure.

11.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- describe the relationship between multinational strategy, structure and their evolution

- define and assess when to employ four organisational structures commonly used in international business
- critically evaluate the strengths and weaknesses of international division, geographic area, global product division and global matrix structures
- discuss what an international business needs to change in its organisation structure to better match its strategy and select a more optimal path
- explain the role of knowledge management as an integrating mechanism and the knowledge implications of different strategies and structures
- define and discuss the concept of organisation architecture and the importance of fit for company performance, and be able to apply the concept of fit in analysing real life examples
- analyse a real-life organisation's attempts to fit environment, strategy and organisation to achieve superior performance, taking a contingency approach.

11.1.3 Essential reading

Willcocks, L. *Global business: management.* (Stratford-upon-Avon, SB Publishing, 2021b) Chapter 2.

11.1.4 Further reading

Buckley, P. et al., 'The internalisation theory of the multinational enterprise: a review of the progress on a 30-year research agenda', *Journal of International Business* 40 2009, pp.1563–80.

Goold, M. and A. Campbell 'Do you have a well-designed organisation?', *Harvard Business Review* 80(3) 2002, pp.117–24 on types of organisation structure.

Malhotra, N. and C. Hinings 'An organisational model for understanding internationalisation processes', *Journal of International Business* 41 2010, pp.330–49.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapter 15, pp.423–31 on knowledge management.

11.1.5 Reference cited

Goold, M. and A. Campbell 'Do you have a well-designed organisation?', *Harvard Business Review,* 80(3) 2002 pp.117–24.

Hill, C. *International business: competing in the global marketplace*. (New York: McGraw Hill, 2021) 13th edition Chapter 14, the organisation of international business.

Willcocks, L. *Global business: strategy in context.* (Stratford-upon-Avon: SB Publishing, 2021a) Chapter 4.

11.1.6 Synopsis of chapter content

Defining organisation structure; centralised and decentralised structures; fit between strategy and structure; international division structure; geographic area structure; global product division structure; global matrix structure; contingency approach to structure; integrating mechanisms; role of knowledge management; organisational architecture and strategy-structure fit.

11.2 Centralised or decentralised structure?

It is important to locate decision making in the most effective place in an organisation. It is not always best to have all the decisions made by a few senior managers at the top of an organisation, not least because they rarely have all the information and knowledge needed to make properly informed decisions about remote events and locations. This becomes a real issue when companies are spreading around many locations and activities across the globe.

In this context Willcocks (2021b) suggests a number of arguments for centralisation:

- To facilitate coordination across countries and activities. For example, a company with a manufacturing site in South Korea might have assembly factories in other countries. Centralised decision-making allows these sets of activities and the related logistics to be coordinated more closely.
- To ensure decisions are consistent with overall organisational objectives. Decentralisation can lead to what is called goal displacement as each sub-unit has the power and inclination to pursue its own interests and sub-goals that may clash with what is optimal for the whole company.
- To give top management the capability to introduce necessary major organisational changes on an international basis.
- To avoid duplication of similar activities, thus gaining scale and resources for that activity (e.g. centralising R&D or production in one or two locations around the globe instead of letting every region do their own R&D).

At the same time, decentralised decision making, or a degree of it, can be a better choice in some circumstances:

- Top management can become overburdened when decision-making is centralised and this can lead to poor decisions.
- Motivational research suggests that people are more committed and work harder in their jobs where they have a greater degree of discretion, control and freedom in their work.
- Decentralisation can increase control. If you establish autonomous, self-contained units within an organisation, you can then hold the sub-unit managers accountable for sub-unit performance.
- Decentralisation can produce better decisions. Here decisions are made closer to the issues by managers who typically have better quality (including informal) information than those higher up the hierarchy, and who are typically more knowledgable in the relevant branch of operations.
- Decentralisation can offer greater flexibility and responsiveness. Cumbersome decision-making processes can be avoided and well-informed decisions made quickly.

Activity

Look at the Unilever case study (VLE Chapter 11). Ask yourself:

1. Why did Unilever's decentralised structure make sense from the 1950s through to the 1970s?
2. Why did this structure start to create problems for the company during the 1980s.

11.3 Revisiting international business strategy

In the Chapter 7, we defined four kinds of multinational strategy:

- international (home replication) strategy
- localisation (multi-domestic) strategy
- global standardisation strategy
- transnational strategy.

These strategies are also discussed in detail in Willcocks (2021a) Chapter 4, section 4.6, pp.121–26. Now let us look at the strategy-structure ‘fit’ challenge on a broader view. There has always been a debate in the business strategy literature as to whether strategy shapes structure, or structure shapes what strategies are possible. But the more fundamental point is that strategy and structure have to be very closely aligned.

Each international strategy is shaped by pressures to integrate globally or be locally responsive, and each strategy best fits with a particular type of structure. Thus, as an overview of what follows:

- A home replication strategy fits with an **international division** structure.
- A localisation strategy fits with a **geographic area** structure.
- A global standardisation strategy fits with a **global product division** structure.
- A transnational strategy fits with a **global matrix** structure.

We will now look at each of these four fundamental types of structure in detail, picking up variants and the reasons for these along the way.

11.4 The international division structure

An international division structure is typically set up when companies initially expand abroad, often when engaging in a home replication strategy. They can encounter a number of problems:

- Foreign subsidiary managers in the international division are not given sufficient voice relative to the heads of domestic divisions.
- International division activities lack synergies because they are not coordinated with the rest of the company that in any case focuses on, and prioritises, domestic activities and results.
- Companies often phase out this structure after initial market entry, and limited expansion, so it may be regarded as temporary and gain little commitment from even its own managers.

An example of this structure at US-based Cardinal Health is shown in Willcocks (2021b) Chapter 2, figure 2.1, p.39. Refer to this now.

Activity

Historically, Starbucks, which operates coffee houses around the world although its headquarters are based in Seattle, USA, had an international division structure. Go online and check their website to see if it still has such a structure. Why do you think it might need to change?

11.5 Geographic area structure

Here, the MNE is organised according to specific geographic areas. An area may be a country if the market is big enough, or a group of countries. Typically, each area tends to be a self-contained, largely autonomous entity with its own set of activities (e.g. marketing, R&D, finance, HR, production). Because such a structure supports local responsiveness, it is the more suitable structure for a localisation strategy. One example is Mittal Steel, a Europe-based, Indian-owned steel company. This has its headquarters in London, UK. In 2007 it had country managers in charge of Poland, Germany, USA, Mexico and Canada. These managers were responsible for production, sales and finance in these countries, on a stand-alone basis. But note that after a merger with Arcelor in 2007, the company moved to a mixed geographic/product division structure to deal with increased size and global market spread.

The problem with this structure is that it encourages fragmentation of the organisation into highly autonomous entities. This can have the following consequences:

- The power base built up in an area can be difficult to control and may resist change, when a more suitable structure is needed by the company as a whole.
- It can be difficult to transfer core competencies and skills between areas to realise location and experience curve economies more widely in the company.

Refer now also to Willcocks (2021b) Chapter 2, figure 2.2. This figure shows the structure of Avon. Headquartered in New York, USA (see www.avoncompany.com), Avon, in 2004, was managed through five geographic areas worldwide. Have a look online at what Avon sells, and think through why it might still want a geographic area structure.

11.6 Global product division structure

Companies that have many products and lines of business domestically will typically adopt a product division structure when they move to operating globally on a large scale. An example is shown in Willcocks (2021b) Chapter 2, figure 2.3. This shows the structure of the European Aeronautic Defence and Space company (EADS) at one moment in time. This is still headquartered in Munich, Germany and Paris, France, and is the largest European defence contractor and maker of commercial aircraft (e.g. the airbus).

At EADS each division is largely self-contained and autonomous, with full responsibility for its own value creation activities. The headquarters (HQ) is responsible for the overall strategic development and financial control of the company. Why use this structure?

- Managers using this structure think that the value-creating activities of each product division should be coordinated by that division worldwide. The product divisions are too different from one another in goals, means and products being sold to merit trying to coordinate activities and effort across the divisions.
- The product divisional structure often evolves as a response to the coordination difficulties experienced with the international division and worldwide geographic area structures.

- With this structure, each division can develop enough scale and core competencies in its product area to achieve economies of scale, location economies and economies from experience curve effects. Thus the structure is good at supporting a global standardisation strategy.

But in this structure power tends to reside with product division managers, so a frequent problem is the lack of voice and power of country managers, resulting in a lack of local responsiveness, and consequent performance challenges.

Activity

Read the still useful article by Goold and Campbell (2002). Note its arguments about good design of an organisation and consider carefully the role of the corporate centre in their thinking. Now look at the examples of Avon, EADS and Cardinal Health (see Willcocks, 2021b, Chapter 2, figures 2.1, 2.2 and 2.3) and ask yourself:

1. What role does headquarters have in each of these structures?
2. What responsibilities and decision-making are best held at the central HQ in these models?
3. Now look at the Unilever case study on the VLE (Chapter 11). What advantages did Unilever gain from adopting the product division structure?

11.7 Global matrix structure

The global matrix structure is an attempt to minimise the limitations of the worldwide area and the worldwide product divisional structure. It is designed to support a transnational strategy where a company is finding that, to survive in its industry, it has to focus simultaneously on realising location and experience curve economies, delivering local responsiveness and enabling the internal transfer of core competencies and knowledge worldwide. Willcocks (2021b) Chapter 2, figure 2.4 shows the classic matrix structure. Look at this now.

You will see that it has both product divisions and geographic areas represented. Thus in figure 2.4, Area 2 and Product Division B management will determine jointly the product offerings, marketing strategy, staffing and resourcing and business strategy for B products sold in Area A. As a result, an individual manager will belong to two hierarchies – an area hierarchy and a product division hierarchy – and so have two bosses. This can create tensions in loyalties and how time is prioritised among managers.

However, historically matrix structures exhibit still further problems including:

- They can be bureaucratic, clumsy and slow.
- They can result in conflicts and power struggles between areas and product divisions due to joint responsibility, diverging interests and viewpoints.
- They can result in finger-pointing between parties when something goes wrong, because it is often difficult to establish accountability in this structure.

Activity

Read the case study ‘Dow Chemical’s matrix structure’ (VLE Chapter 11). Read also Willcocks (2021b) Chapter 2, section 2.7, pp.42–43 on this subject.

1. Why did Dow Chemical adopt a matrix structure?

2. Why did it underperform?
3. Do you think its modified matrix structure was a good idea?
4. Why did Dow eventually move to a global business division structure?

11.8 Evolution of structure and the need for a contingency approach

Companies that continue to expand into international markets and grow in size will tend to expand from an international division structure to:

1. Either a worldwide product divisional structure – adopted by companies that are quite diversified, which:
    - allows for worldwide coordination of value creation activities of each product division
    - helps realise location and experience curve economies
    - facilitates the transfer of core competencies does not allow for local responsiveness.
2. Or a worldwide area structure – favoured by companies with a low degree of diversification and a domestic structure based on function, which:
    - divides the world into autonomous geographic areas decentralises operational authority
    - facilitates local responsiveness
    - can result in a fragmentation of the organisation is consistent with a localisation strategy.

Research work by Stopford and Wells (1972) developed the useful Stopford-Wells framework to show the likely evolution of structure towards the global matrix grid, as a company's foreign product diversity increases along with its foreign sales as a percentage of total sales. Their theory of structural evolution is shown in Willcocks (2021) figure 2.5. Refer to this now.

Since this theory was developed, the international business world has changed dramatically in terms of dynamism, size, new players and competitiveness. The four organisation structures are rarely found today in their pure forms. Flatter hierarchical organisational forms, which are also strongly networked, are popular today. Coordination and integration mechanisms are also key to the functioning of globally operating companies. As an example of a company's response to the modern environment, consider the relatively new organisation of global player Nestlé:

Nestlé is widely known as the world's largest multinational food and beverage company, with a 154-year history and operations in virtually every country in the world. Nestlé was founded in the year 1866 by Swiss pharmacist Henri Nestlé in Vevey, Switzerland. With successful product expansion and business strategies, Nestlé now employs roughly 339,000 people and has factories or operations in almost every region. Nestlé owns a variety of major consumer brands such as Nescafé, Kit-Kat, Carnation, PowerBar and so forth that have a dominant position in a variety of markets. The industry leadership of Nestlé largely depends on the company's R&D networks and activities. This enables Nestlé to provide high quality, safe and healthy food and beverage categories for worldwide consumers continuously.

Aiming to become the food industry leader in nutrition, health and wellness, Nestlé is committed to promoting corporate common goals and create shared values within a decentralised organisational model. The company typically implements differentiation and low-cost leadership strategies to occupy or retain the target markets. They also established a global hybrid or mixed structure that empower regional managers, who report back to the headquarters, to have autonomy for their specific business operations and decision-making processes. Although Nestlé has certain competitive advantages for persevering in the market, the company still faces challenges due to external environments and internal factors in today's dynamic and high velocity global markets. So how does Nestlé structure itself?

Its corporate headquarters directly controls centralised functions, global product groups, R&D and five regional organisations:

- Centralised functions: finance and control, information systems, logistics, e-commerce, HQ corporate affairs.
- Global product groups: each product group is responsible for its own strategy, business development, mergers and acquisitions and market entry.
- R&D: this function covers and is located in 13 countries.
- Regional organisations: there are five which report directly to HQ. Each region has a number of countries reporting to it with each country manager responsible for sales in that country.

This example tells us that no organisational form is ever the last word in organisation structure and new forms emerge as needs and requirements change. National and local context still influence greatly the way in which modern subsidiaries are organised. Contingency theory can be usefully applied to MNE organisations nowadays. Contingency means that different organisations are designed to fit different specific circumstances.

In practice, MNEs have to search continually for better ways of accessing and utilising all their scarce resources within the company. Modern MNE organisational structures must now enable optimisation of integration mechanisms in order to operate effectively.

Activity

Look at the Nestlé structure described above. Think through the factors, which led them to have this structure:

1. What are the roles of strategy, environment, local conditions and competition?
2. Why are some functions centralised?
3. Why have global product groups?
4. Why is R&D so centralised?
5. Why do regional organisations operate primarily as local sales functions?

11.9 Integrating mechanisms and the role of knowledge management

When companies pursue global standardisation and transnational strategies they develop additional complexity. Coordination problems become ever greater and more important to deal with. MNEs typically have a profusion of sub-units each with their own orientations, ways of working and goals. For Unilever (see case study, VLE Chapter 11) this created, at one time in its history, real problems with introducing new products into Europe across many years. Resolving disputes between its many national and product divisions extended the time for introducing new products. This denied Unilever the first-mover advantage vital to building a strong market position.

Formal mechanisms for integrating sub-units include simple direct contact between unit managers, developing specific liaison or lynch-pin roles to develop coordination and communication between units, and forming cross-unit temporary teams to take on specific projects system of common interest and needing resources from the different sub-units (e.g. the development and introduction of a new product or the implementation of a new global accounting information system).

But all these solutions have limitations and need to be supported by informal integrating mechanisms. As a result, you will find most MNEs experimenting with or operating knowledge networks supported by an organisation culture that values teamwork and cross-unit cooperation. Increasingly these are supported by information and communications technologies, with much learning on this gained from the 2020–21 pandemic and economic crises.

Knowledge management is the structures, processes and systems that develop, leverage and transfer knowledge. Knowledge is a broader concept, including not just factual information but also the know-how and know-why embedded in individuals and the company. Knowledge has two dimensions. Explicit knowledge is codifiable, in other words it can be written down, stored and transferred with little loss of richness of message. As we shall see, information systems based on information and communications technologies (see Chapter 13) are widely used in international business, and are very good for storing, transferring and leveraging explicit knowledge. But tacit knowledge is not codifiable; it is personal, built through doing and experience and its acquisition and transfer requires hands-on practice.

The knowledge management challenge, then, for international businesses is to organise formal systems and processes that deal with explicit knowledge (e.g. databases, intellectual property, expert systems) and also create learning mechanisms by which tacit knowledge can be shared, transferred and leveraged (e.g. knowledge networks, Zoom meetings, use of social media). Both integration strategies can be greatly enhanced by the use of information and communications technologies in the globally operating company. One means is a knowledge network.

All the Big Four consultancy companies – PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst and Young and KPMG (see Activity below) – and all global companies that need to share knowledge across sub-units or within sub-units have such global networks, allowing informal contacts between managers and knowledge specialists as need arises.

Another means of sharing knowledge is through communities of practice, established between groups of people doing similar or related work, in order to share and create knowledge. This enables people to experiment and innovate informally on the job. When such communities are IT-enabled, they operate as virtual communities of practice. The Big Four also endeavour to codify (i.e. collect, store and make available) as much explicit knowledge as possible so as to create a collective memory system that can be leveraged when similar issues and challenges need to be dealt with.

Organisations do experience difficulties in getting sub-units to share knowledge because knowledge frequently gives a person or sub-unit power. To counter this, companies try to develop a strong, sharing, cooperative culture to support the development of processes and structures and modes of knowledge development and communication. It is also important to put in incentives that support such a culture and the behaviours it implies.

Activity

Read the section on managing knowledge in global companies in Willcocks (2021b) Chapter 2, section 2.9, pp.45–47. Read also the case study on the VLE, Chapter 11: 'How the "Big Four" organise themselves globally'. Ask yourself:

1. How vital is knowledge and its management to a Big Four company? How is knowledge being used to leverage company performance globally? What barriers to sharing knowledge might there be in a Big Four company?
2. Assess the structures of the Big Four from a knowledge, creation and exploitation perspective. Do they have the best structures and arrangements to achieve these goals? Can you think of improvements?

11.10 Fitting strategy, structure and organisation architecture

Organisation structure is part of a larger set of factors, which we will call, following Hill (2021), **organisational architecture**. Organisational architecture is summarised in Willcocks (2021b) Chapter 2, figure 2.6. Look at this now. Organisational architecture is the totality of a company's organisation including:

1. **Organisational structure**
   - The formal division of the organisation into sub-units.
   - The location of decision-making responsibilities within that structure – centralised versus decentralised.
   - The establishment of integrating mechanisms to coordinate the activities of sub-units including cross-functional teams or pan-regional committees.
2. **Control systems and incentives**
   - The control metrics used to measure performance of sub-units, managers and employees. The main control systems are personal controls, bureaucratic controls, output controls and cultural controls (where an employee buys into the norms and value systems of the company).
   - The incentive devices used to reward sub-unit, managerial and employee behaviour. For example, targets linked to profitability can be used to measure sub-unit performance. Employees might be rewarded for exceeding those targets (e.g. given a share of profits achieved beyond targets).
3. **Processes**
   - The manner in which decisions are made and work is performed within the organisation. Processes can be found at many different levels of the organisation. For example, there are processes for formulating strategy, allocating resources, handling customer enquiries, improving product quality, evaluating employee

performance, etc. It is important to distinguish the core processes on which the mission and competitive advantage of the company depends, and the support processes which are necessary and enabling but do not differentiate the company's products/services in the market place (see also Chapter 7). The need to take an end-to-end view of the process is critical for success and this needs integrating mechanisms and cross-organisation cooperation. As an example, to design a new software product may require an MNE to use R&D personnel in California, production people in Taiwan and marketing people located in Europe, Asia and North and South America.

4. **Organisational culture**
    - The norms and value systems that are shared among the employees of an organisation. To integrate activity when operating worldwide, some companies try to have strong cultures. For example, Accenture summarises its culture as 'High performance. Delivered.' Shared cultures stressing cooperation can help in rendering effective informal integrating mechanisms such as knowledge networks. Note that strong cultures are not always supportive of, and may even inhibit, strong international performance. Culture is covered in more detail in this guide, Chapters 3 and 14.
5. **Organisational culture**
    - The norms and value systems that are shared among the employees of an organisation. To integrate activity when operating worldwide, some companies try to have strong cultures. For example, Accenture summarises its culture as 'High performance. Delivered.' Shared cultures stressing cooperation can help in rendering effective informal integrating mechanisms such as knowledge networks. Note that strong cultures are not always supportive of, and may even inhibit, strong international performance. Culture is covered in more detail in this guide, Chapters 3 and 14.
6. **People**
    - The employees and the strategy used to recruit, compensate and retain those individuals and the type of people they are in terms of their skills, values and orientation. This subject is covered in detail in guide, Chapter 14.

Superior company profitability requires three things to happen: the different elements of a company's organisational architecture must be internally consistent, the organisational architecture must fit the company's strategy, and the strategy and architecture of the company must fit with competitive conditions prevailing in the company's markets. We are dealing primarily with structure in this chapter and the other four components of organisational architecture are dealt with in other chapters. See Chapter 14 in particular for more on people, culture, incentives and controls.

Activity

Reconsider the case study Chapter 11 'How the "Big Four" organise themselves globally' (VLE Chapter 11) from a people perspective:

1. What is the importance of the people dimension in these sorts of knowledge-intensive companies?

2. Find out what the human resource policies are of one of the Big Four, for example by going on to www.accenture.com and looking at how that company attracts candidates and what it offers to prospective employees.

Now read Willcocks (2021b) Chapter 2 to consolidate your learning, making note of additional points and illustrative cases.

11.11 Key concepts

The key concepts in this chapter are:

- organisation structure
- organisational architecture
- matrix structure
- geographic area structure
- international division
- centralisation versus decentralisation
- knowledge management
- global product division
- integrating mechanism
- strategy-structure-organisation 'fit'
- Stopford-Wells framework.

11.12 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- describe the relationship between multinational strategy, structure and their evolution
- define and assess when to employ four organisational structures commonly used in international business
- critically evaluate the strengths and weaknesses of international division, geographic area, global product division and global matrix structures
- discuss what an international business needs to change in its organisation structure to better match its strategy and select a more optimal path
- explain the role of knowledge management as an integrating mechanism and the knowledge implications of different strategies and structures
- define and discuss the concept of organisation architecture and the importance of fit for company performance, and be able to apply the concept of fit in analysing real life examples
- analyse a real-life organisation's attempts to fit environment, strategy and organisation to achieve superior performance, taking a contingency approach.

11.13 Test your knowledge and understanding

1. How important is the internalisation theory of the MNE? Are there better theories or are they just complementary? Note: you will need to read Buckley et al. (2009) to answer this exercise.
2. Look at the Unilever case study (VLE Chapter 11). Answer the following questions:
    a. What was Unilever trying to do when introducing a new business group structure in the 1990s? Why did this structure fail to solve Unilever's problems?
    b. In the 2000s Unilever switched to a structure based on global product divisions. Why? Does this structure make sense given the nature of competition in the food and detergent business?
    c. Go to Unilever's website and look the company up on Wikipedia. Find out what its present structure is and whether you think it's suitable for 2021 onwards.
3. Look at case study: 'Sharenet: and ICN knowledge-management at Siemens' (VLE Chapter 11). Ask yourself:
    a. Why was the system set up?
    b. Why do you think the system met with much resistance?
    c. What incentives were put in place to make knowledge sharing attractive to stakeholders?

As an enrichment activity, have a look at this video on Sharenet knowledge management at Siemens:

- www.youtube.com/watch?v=WUy6WWQc36Q

11.14 Sample examination question

'International business strategy only gets executed effectively when it is aligned with organisational structure and with organisation architecture.'

Discuss this statement as follows:

a. Outline the main international business strategies.
b. Explain the organisation structure that best supports each strategy, and the limitations of each structure. Give illustrative examples.
c. Assess the main components of organisation architecture, and illustrate, with examples, how these components need to be aligned with strategy and structure.

Notes

Chapter 12: Global sourcing of production and services

12.1 Introduction

Where should a company locate its production activities? Should all production be located in a single market, or is there a reason to locate different activities in different places? What is the long-term strategic role of foreign production sites? What factors might cause a company to change its strategy? Should a company outsource production/services or handle activities in-house? How can production and logistics be conducted internationally not only to lower the costs of value creation but also to add value by better serving customer needs? What factors determine location attractiveness? These are the sorts of questions this chapter seeks to answer.

In this chapter, **global sourcing** is defined as the procurement of products or services from suppliers or company-owned subsidiaries located abroad for consumption in the home country or a third country. **Outsourcing** refers to the procurement of selected value-adding activities, including production of intermediate goods or finished products or services, from independent suppliers. Outsourcing, as such, is the handing over to third-party management of selected activities for required outcomes. Companies outsource because they generally are not superior at performing **all** primary and support activities. Most value-adding activities – from manufacturing to marketing to after-sales service – are candidates for outsourcing. Managers must decide between **internalisation** and **externalisation** (i.e. whether each value-adding activity should be conducted in-house or by an independent supplier).

In this chapter, we look at the factors that influence a company's choices about locating production and services around the world. We explain how companies deal with make-or-buy and offshoring decisions for both production and services. You will also be introduced to a model of the main factors that companies consider when assessing location attractiveness, the risks in outsourcing and offshoring and how they can be reduced, and a discussion on managing sourcing decisions for services, and managing across the outsourcing services life cycle.

Be aware that, following the 2020–21 crisis, organisations have been seeking greater resilience in their supply chains. Willcocks (2021b) section 4.1, pp.82–85, gives details on the new practices being adopted.

12.1.1 Aims of the chapter

The aims of this chapter are to:

- establish the nature of outsourcing, offshoring, captive offshoring and the strengths and risks of these different global sourcing decisions
- establish the major criteria for making production and service location decisions
- introduce the make-or-buy decision framework and the advantages and risks of in-house or outsourced production and services
- identify the major risks in sourcing globally rather than domestically
- present a framework for analysing location attractiveness based on 20 factors that need to be considered

- establish how international companies can make business and IT service sourcing decisions, offset the risks stemming from its sourcing approach, and manage across the outsourcing services life cycle.

12.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- outline the trends towards outsourcing, global sourcing and offshoring
- discuss the benefits and challenges of global sourcing of production for the company
- list the major factors that influence production location
- describe the components of make-or-buy decision making and be able to apply the concept to real case decisions
- list the strategies for minimising risk in global sourcing
- define the nature of offshoring and its challenges to business organisations, and identify challenges and make recommendations on offshoring strategy
- describe and be able to apply a framework for identifying global location attractiveness
- for services, make business services and IT sourcing decisions in a global context, while assessing and reducing the risks in offshoring
- for services, define the principles of managing across the business services and IT outsourcing life cycle.

12.1.3 Essential reading

Cullen, S., P. Seddon and L. Willcocks 'Managing the outsourcing lifecycle imperative', *MISQ Executive* 4(1) 2005, pp.229–46.

Gottfredson, M., R. Puryear and S. Phillips 'Strategic sourcing', *Harvard Business Review* 83(2) 2005, pp.132–39.

Trent, R. and Monczka, R. 'Achieving excellence in global sourcing', *Sloan Management Review* 2005 47(1) pp.24–32.

Willcocks, L. *Global business: management.* (Stratford: SB Publishing, 2021b) Chapter 4.

12.1.4 Further reading

Liu, R. et al. 'Why are different services outsourced to different countries?', *Journal of International Business* 42 2011 pp.558–71.

Oshri, I., J. Kotlarsky and L. Willcocks *The handbook of global outsourcing and offshoring*. (Basingstoke: Palgrave Macmillan, 2021) Chapters 2 and 3.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapters 4, and 17.

12.1.5 Synopsis of chapter content

How to locate production globally; criteria used; make or buy decisions; offshoring production and services; deciding on location attractiveness: 20 factors; identifying and mitigating sourcing risks; strategic sourcing decisions for business and IT services; managing across the outsourcing life cycle.

Activity

Read Willcocks (2021b) Chapter 4, section 4.1, pp.82–85, Gottfredson et al. (2005) and Trent and Monckzka (2005). Then answer the following questions:

1. What are the main drivers of global sourcing? Make a detailed list that you can use for revision, including examples.
2. From reading this, how do you think the 2020–21 crises have changed how organisations manage sourcing and supply chains? What practices have they been adopting more recently to reduce their risks?

12.2 Locating production

Production refers to activities involved in creating a product. **Logistics** refers to the procurement and physical transmission of material through the supply chain from the supplier to the customer (see also Chapter 10). The production and logistics functions of a company have two main strategic objectives; first, to lower costs and second, to eliminate defective products from the supply chain and the manufacturing process. These two objectives are interrelated so that, for example, a company that improves quality control will also reduce the cost of value creation.

Companies want to locate production so that they are able to accommodate demands for local responsiveness and to respond quickly to shifts in customer demand. For example, several global automakers – like Hyundai – have been shifting production to India to take advantage of that country's low-cost labour force. There are at least four major factors that might affect the choice of production location:

Country factors: There are many country factors that influence the decision of where to produce, and we will discuss these in more detail below. For a location to be even a possibility, skilled labour and supporting industries must be available. As we saw in Chapters 2, 4 and 5 regulations on foreign direct investment (FDI) and trade can significantly affect the attractiveness of a country as a production location. In addition, expectations about the future value of a currency can also influence the decision about where to produce (see Chapter 6). Transportation costs are another factor to consider. For example, China has proved to be a successful production location for the Dutch company, Phillips NV. Will this continue into the 2020s?

Fixed costs: Sometimes, the fixed costs of setting up a manufacturing plant are so high that a company needs to serve the world market from very few locations or even from a single location. But the opposite is also true. If fixed costs are low, multiple locations might make sense. How does minimum efficient scale affect the choice of production location? The larger the minimum efficient scale of a plant, the more likely it is that a company will centralise production in a single location or produce in just a few locations.

Technological factors: How do new technologies influence the decision about where to locate production? In Chapter 7 we saw that to achieve economies of scale and the cost savings associated with them, companies need to mass produce standardised products. We typically think that companies that produce a greater variety of products have shorter production runs. However, these traditional practices are changing. Today, flexible manufacturing – also called lean production – has been changing the way companies produce, allowing them to challenge the traditional rules of production. These new technologies are designed to reduce set-up times for complex equipment, increase the utilisation of individual machines through better scheduling and improve quality control at all stages of the manufacturing process. Why is flexible manufacturing so important? Flexible manufacturing allows companies to produce a wide variety of products at a unit cost that would normally be associated with the mass production of a standardised product.

- **Product factors**: Here there are at least two important factors to consider:
  1. The product's value-to-weight ratio. If the value-to-weight ratio is high (as it might be with a pharmaceutical product), then it makes sense to produce the product in a single location and export it to other parts of the world. In contrast, when the value-to-weight ratio is low (e.g. with cement, paint or a car), there is more pressure to manufacture the product in multiple locations around the world.
  2. The product's level of standardisation. When there are few differences in consumer tastes and preferences, the need to be locally responsive is reduced and centralised manufacturing makes sense. So, for example, a company might produce calculators or video game consoles at a single location because they can be produced in bulk.

12.2.1 Multiple or few locations?

Companies should concentrate production in just a few locations when they have substantial fixed costs, when the minimum efficient scale of production is high and when flexible manufacturing is an option. Establishing multiple production locations can make sense when both fixed costs and minimum efficient scale of production are relatively low and when flexible manufacturing is a poor alternative. Look now at Willcocks (2021b) Chapter 4, p.88, table 4.1. This provides a summary of the conditions under which concentrated or decentralised production are favoured.

Note that the strategic advantage of foreign factories can change over time. A foreign factory established to make a standard product to serve a local market, or to take advantage of low cost inputs, can evolve into a facility with advanced design capabilities. Hewlett Packard, for example, located its production in Singapore to take advantage of low costs there, but today the facility is an important centre for designing and assembling portable ink jet printers (see Activity below). As government regulations change, or as countries upgrade their factors of production, the strategic advantage of a particular location can change. Think about your own country and the changes there – have foreign factories been arriving or leaving, in the last five to seven years?

Activity

Read the case study 'Philips NV in China' (VLE Chapter 12). This describes Philips NV's operations in China. Philips NV, the Dutch consumer electronics, lighting, semiconductor and medical equipment conglomerate, has been operating factories in China since 1985. By 2002, the company had invested $2.5 billion in China and operated 23 factories there. Initially, Philips believed that it would sell a large portion of its output to the local Chinese market. However, the company quickly discovered that the low wages that make China such an attractive production location also meant that the market for its products was smaller than anticipated. Philips' solution was to export most of its output to the USA and elsewhere. You can explore the company in more depth by going to its website at www.philips.com and clicking on 'Visit Philips Global'. Ask yourself:

1. What made China such an attractive production location for Philips? Are there other locations that share the same characteristics?
2. Philips wanted eventually to turn China into a global supply base from which its products will be exported around the world. Consider the advantages and disadvantages of this strategy.
3. How was the strategy paying off as at 2021? Carry out an internet search here, looking at the company's latest annual report and its activities in China.

12.3 Make-or-buy decisions

Should an international business make or buy the component parts to go into their final product? The decision of whether to perform an activity in-house or outsource it to another company is called the **make-or-buy decision**. It is an important factor in many companies' manufacturing (and also their service) strategies. Toyota, for example, actually produces less than 30 per cent of the value of its cars, the rest being outsourced to other companies. Companies typically internalise those value-chain activities considered a part of their **core competence** (see Chapter 8) or which involve the use of proprietary knowledge and trade secrets that they want to control. Make-or-buy decisions are much more complex when they involve international markets than when they involve domestic markets. Willcocks (2021b) p.90, figure 4.1 presents the make-or-buy decision-making process. Refer to this now.

Making components in-house (or vertical integration as it is also called) has several advantages:

- **Lowers costs**: If a company is already the most efficient producer of certain products, it makes little sense to outsource to a less efficient producer.
- **Facilitates investments in specialised assets**: When a company has to invest in specialised assets, or assets whose value is contingent upon a particular relationship persisting, internal production makes sense.
- **Protects proprietary technology**: A company that outsources something that contains proprietary information runs the risk of losing control over that information. Boeing, for example, manufactures its own cockpits so as not to give away proprietary information to competitors.
- **Facilitates the scheduling of adjacent processes**: Companies that manufacture in-house also have more control over the planning, coordination and scheduling or adjacent processes. For companies with just-in time inventory systems, this can be a real advantage.

Why should a company outsource or buy components? Here are some major reasons given by companies.

- **Strategic flexibility**: Buying parts from independent suppliers gives a company greater flexibility. By buying parts from outside suppliers, companies can switch orders between suppliers as circumstances change.
- **Cost**: By outsourcing, companies have lower costs because they can avoid the challenges involved in coordinating and controlling the additional activities that would be involved in making the components in-house. Companies can also lower costs when they avoid the lack of incentive that often comes with using internal suppliers with a captive customer. In addition, it can be difficult to decide how to set transfer prices when products are made in-house. A number of factors (e.g. exchange rates changes, the ignorance of headquarters about local conditions) can affect how prices should be set. In practice also the supplier may well have lower costs because of scale (e.g. producing for a number of customers).
- **Order capture**: This helps the company capture orders from international customers. Boeing was able to get a large order from Air India, for example, while at the same time agreed to shift some subcontracting work to Indian suppliers.

12.4 Offshoring global services and production

Offshoring is a natural extension of global sourcing and refers to the relocation of a business process, a business/IT service or an entire manufacturing facility to a foreign country. This can be done on a **captive** offshoring basis (i.e. using a fully or partly owned subsidiary) or by offshore **outsourcing**. It is important not to assume that offshoring is the same as outsourcing, so look at Willcocks (2021b) p.92, figure 4.2 to clarify the different types of sourcing.

MNEs are particularly active in shifting production facilities or business processes to foreign countries to enhance their competitive advantages. Offshoring is especially common in the service sector (e.g. banking, software code writing, legal services and customer-service activities). For example, large legal hubs have emerged in India that provide services such as drafting contracts and patent applications, conducting research and negotiations, as well as performing paralegal work on behalf of western clients. With lawyers in North America and Europe costing $300 an hour or more, Indian companies (in 2012) could cut legal bills by 75 per cent.

When is offshoring problematic? The following are suggestions only, but offer an opportunity to think through offshoring decisions seriously.

- **Service with customer interaction**: In many service sectors the service cannot be separated from its place of consumption. People normally do not travel abroad to see a doctor, dentist, lawyer or accountant (though this is changing – medical care industry developments in India, for example). Consequently, many service jobs will never be offshored.
- **Strategic goals**: Cost-cutting by offshoring is often a distraction from more beneficial, long-term goals such as enhancing the quality of offerings, improving overall productivity and freeing up knowledge workers and other core resources that can be redeployed to improve long-term performance.

- **Stakeholder resistance**: Global sourcing tends to invite opposition from employees and other organisational stakeholders.
- **Challenges**: There are multiple challenges to offshoring:
  - A common reason for global sourcing failure is that, when outsourcing, both buyers and suppliers tend not to spend enough time upfront to get to know each other well. They rush into a deal before clarifying partner expectations, which can give rise to misunderstandings and inferior results.
  - There may be a lot of exposure to exchange rate fluctuations.
  - Partner selection, qualification and monitoring costs may be prohibitively high.
  - The increased complexity of managing a worldwide network of production/service locations and partners as well as a global
  - The supply chain may be too great for internal resources to manage.
  - There is potential vulnerability to opportunistic behaviour or actions in bad faith by outsourcing suppliers.
  - The company might experience constraints in its ability to safeguard its intellectual assets.

Much has been written about how offshore outsourcing can be managed effectively and we will look at further below.

Activity

Read the case study Chapter 12 'Lenovo and in-house production' (VLE Chapter 12). Ask yourself:

1. Why does Lenovo decide to go for in-house production? Is this a strategic measure or simply a cost-saving one?
2. What would be the advantages and disadvantages of outsourcing production for Lenovo?
3. If Lenovo makes this in-house sourcing decision, why do many of its competitors outsource a lot more? Who do you think is right?
4. Did Lenovo change its sourcing practices after the 2020–21 pandemic and economic crises? Check by carrying out an online search.

12.5 Deciding on location attractiveness

Selecting a location is one of the major challenges when making offshoring and outsourcing decisions. Below we provide a summary of the 20 major factors that must be considered when assessing country attractiveness. These are grouped into six areas and based on Willcocks (2021b) p.95, table 4.2. You must read Willcocks (2021b) Chapter 4, section 4.5, pp.94–98, for this component of the subject area.

1. Costs

- Labour costs (average wages for skilled workers and managers).
- Infrastructure costs (unit costs for telecom networks, internet access and power, and office rent).
- Corporate taxes (tax breaks and regulations and other incentives for local investment).

2. Skills

- Skill pool (the size of the labour pool with required skills). Required skills may include technical and business knowledge, management skills, languages and the ability to learn new concepts and innovate. The scalability of labour resources in the long term (i.e. the ability to supply sufficient labour resources to meet growing demand) is a major issue to consider when choosing a sourcing destination. An indication of the scalability of labour resources in a country is the annual growth in the number of graduates with desired skills. Countries that offer scalability of labour resources are also more likely to keep wages relatively low due to the constant supply of new graduates.
- Vendor landscape (the size of the local sector providing IT services and other business functions). For clients looking to outsource IT or business processes, it is imperative to evaluate the vendor's landscape in terms of the general skills set (or capabilities) and competencies of vendors.

3. Business and living environment

- Governance support (policy on foreign investment, labour laws, bureaucratic and regulatory burden, level of corruption).
- Business environment (compatibility with prevailing business culture and ethics).
- Living environment (overall quality of life, prevalence of hiv infection, serious crime per capita).
- Accessibility (travel time, flight frequency, time difference).

4. Quality of infrastructure environment

- Telecommunication and IT (network downtime, speed of service restoration and connectivity).
- Real estate (both the availability and quality).
- Transportation (scale and quality of road and rail networks).
- Power (reliability of power supply).

5. Risk profile

- Security issues (risks to personal security and property-related issues such as fraud, crime and terrorism).
- Disruptive events (including the risk of a labour uprising, political unrest and natural disasters).
- Regulatory risks (the stability, fairness and efficiency of the legal framework).
- Macroeconomic risks (such as cost inflation, currency fluctuation and capital freedom).
- Intellectual property risk (strength of the data protection regime).

6. Market potential

- Attractiveness of the local market (the current gross domestic product and its growth rate).
- Access to nearby markets (in both the host country and adjacent regions.

Activity

Read the case study 'PanGenesis and offshore out-sourcing' (VLE Chapter 12) to illustrate Area 2 (skills) in the above model for assessing country attractiveness.

Now read Willcocks (2021b) Chapter 4, sections 4.4 to 4.7, and answer the following questions:

1. You are a major Asia Pacific airline operating out of Singapore. Why would you consider outsourcing your mainframe processing to Australia? Use the location attractiveness matrix to make a preliminary judgement.
2. Cathay Pacific actually did this. Find out whether they still do this by doing an internet search on the company.

12.6 Global business and IT services: sourcing decisions and risks

You have covered a lot of this subject already! In this chapter you have already learned about make-or-buy decisions (12.3); offshoring global services and production (12.4); and deciding on location attractiveness (12.5). In this section we will focus specifically on three issues: making the IT sourcing decision, outsourcing and offshoring risks, and how to manage across the outsourcing life cycle.

According to Willcocks and Lacity (2012), by 2012 the IT and business services outsourcing market was worth over $450 billion in annual revenues. Of this, about $65 billion represented the offshore outsourcing market. However, we talk here of global IT **sourcing** because outsourcing is by no means always the best option, and does incur a range of risks.

Good management can mitigate these risks. A range of sourcing options and their definitions are given below and are also discussed in detail in Willcocks (2021) Chapter 4, pp.99–104, section 4.7.

- **In-house provision; insourcing**
  - A sourcing option in which the organisation owns the IT assets and employs its own IT staff.
- **Staff augmentation; contract labour**
  - A sourcing option in which an organisation buys in low- to mid-level labour to supplement in-house capabilities; the client manages the people, usually at the client site.
- **Management consulting**
  - A sourcing option in which an organisation buys in high-level expertise to supplement in-house capabilities.
- **Shared services**
  - A sourcing option in which an organisation centralises and standardises IT delivery.
- **Traditional outsourcing; fee-for- service outsourcing; exchange-based outsourcing**
  - A sourcing option in which a client pays a fee to a provider in exchange for the management and delivery of specified IT services. The client is in charge of specifying needs and the provider is in charge of managing the resources to deliver those needs.
- **Cloud computing; netsourcing; application service provision**
  - With this utility model, clients pay a usage- based fee to providers in exchange for services being delivered over a network, typically the internet.

- **Joint ventures; strategic partnerships**
  - A specific type of contract entered into by two or more parties in which each agrees to furnish a part of the capital and labour for a business enterprise.

There are a number of sourcing options available. Using the scope of outsourcing as a criterion (i.e. the degree to which a process is managed internally or by a third party), Willcocks (2021b) distinguishes three models:

- **Total outsourcing**: transferring more than 80 per cent of a function's operating budget to external providers.
- **Total in-house sourcing**: retaining the management and provision of more than 80 per cent of the function's operating budget within the organisation.
- **Selective outsourcing**: sourcing selected functions to external parties while managing 20 to 80 per cent of the function's operating budget internally.

When outsourcing, organisations also have to decide about the number of providers to engage. Selective multi sourcing has the advantages of choosing best-of-breed providers, mitigating the risks of relying too much on one provider and helping clients adapt in changing environments.

Multi-sourcing has several disadvantages, including increased transaction costs as organisations manage more providers, interdependencies and interfaces. The major advantages of bundled services from a single provider include simplified procurement, simplified governance, fewer transaction costs, and economies of scale and scope. But bundled services increase switching costs and the risks of relying on one provider.

How can you make strategic sourcing decisions about IT? Willcocks (2021b) suggests a process to evaluate which activities are good candidates for outsourcing and which are not. He suggests that business activities should be assessed in terms of their contribution to business operations, as well as in terms of their contribution to competitive positioning. At this point look at Willcocks (2021b) figure 4.3, p.102. This suggests four types of business activities:

- **'Order winners'** are activities that contribute greatly to the company's business operations and its competitive positioning. These activities in essence constitute the basis of the company's differentiation relative to its competitors and should be kept in-house. For example, such activities for Dell, the computer multinational, include those that maintain and enhance the speed of operations and its focus on core business.
- **'Qualifiers'** are activities that are critical for business operations yet do not contribute to the company's competitive positioning in a major way. These activities should be 'best' sourced, which could include the involvement of a third party if it meets the right cost and quality criteria and has strong partnering capability. For example, aircraft maintenance systems are a minimum requirement for airlines to compete in the industry, but they do not constitute an important differentiator between airlines.
- **'Useful commodities' or 'necessary evils'** are activities that do not contribute significantly to the company's business or its competitive positioning. These activities constitute good candidates for outsourcing. For example, in the case of Dell in the early 2000s, such

activities included administration, inventory and payroll tasks. Most IT outsourcing is of this type (e.g. desktop maintenance, data centres, payroll, accounting systems). Typically the safest activities are discrete, mature and stable.

- **'Distractions'** are failing attempts to differentiate a company from its competitors. These activities should be eliminated or migrated to another quadrant. For example, Dell in 1989 opened retail outlets, but soon it discovered that its major distinctive competence was the direct model of selling.

Having identified activities that are **outsourcing candidates**, Willcocks (2021b) suggests another matrix to evaluate whether the market can service the requirement. If the market is not cheap, capable or mature enough, then the organisation will need to seek a largely in-house solution. Now look at Willcocks (2021b) p.103, figure 4.5. This figure captures the major elements for consideration and plots the cost efficiencies and capabilities the market can offer against carrying out the activity internally.

Where the market can carry out a task cheaper and better, then outsourcing is the obvious decision, but only for 'qualifiers' and 'necessary evils'. As an example, Federal Express provides customer delivery for Dell. Where the market (i.e. Federal Express in this case) offers an inferior cost and capability, then in-house sourcing would be the better alternative.

Where the market offers a better cost deal, then this should be taken, but only for non-key activities ('necessary evils'). Where the market offers superior capability but at a premium price above what the in-house cost might be, there may still be good reasons for buying in or close partnering with the third party, not least to leverage and learn from their expertise and apply it to 'qualifying' and even 'order-winning' tasks.

In summary, what factors **do** make an IT activity a less risky outsourcing candidate? These are the main business, economic and technical reasons:

1. useful/critical commodities vs. critical differentiators
2. discrete IT activities vs. IT integrated into complex processes
3. stable, mature IT activities vs. new technologies, development/innovation tasks
4. market cheaper and/or better vs. in-house costly and/or inferior capabilities
5. IT/business processes re-engineered vs. outsourcing IT problems/messes.

With regard to offshoring candidates and risks, Oshri, Kotlarsky and Willcocks (2021) review a number of studies and note the following:

1. Processes that require substantial levels of communication between the client and the supplier do not constitute good candidates for offshoring. Time zone differences, language and other sorts of communications barriers can shrink the benefits of offshoring.
2. Processes important for the creation of value should not be offshored.
3. Executives should consider how crucial a process is in the creation of customer value compared to other processes. For the processes that rank highly, such as working capital management and cash-flow forecasting, offshoring is not suggested. Processes that rank lower (e.g. payment authorisation and invoice verification) appear better candidates for offshoring.
4. Operational risk refers to the danger that processes will not function properly and operate smoothly after offshoring. It is important to

evaluate the extent to which processes can be codified and measured. **Transparent processes** (e.g. transaction processing, tele-collection and technical support) can be clearly measured in terms of quality and are the tasks that can be fully codified. **Codifiable processes** can be measured to some extent in terms of the quality of their execution and most of the work can be codified. **Opaque processes** can be codified in terms of the work being done, but the quality of the process outputs is difficult to measure (e.g. for processes such as insurance underwriting, invoice management and cash flow forecasting). This creates risks in offshoring. **Non-codifiable processes**, such as supply chain coordination and customer data analysis, cannot be easily measured in terms of the quality being achieved (such as pricing) and usually carry a high amount of operational risk.

5. If you can monitor work and use precise metrics to measure process quality then the degree of structural risk will be lowered.
6. When companies source processes that require the transfer of a large amount of knowledge, they have to invest time and effort to pass this knowledge on to the supplier's employees. Furthermore, some processes take a long time to stabilise when they are offshored. In both cases, the cost of switching providers is very high.
7. The complexity of processes plays a significant role in offshoring decisions. Oshri et al. (2021) Chapter 2, provides a useful set of criteria for evaluating process complexity that can help executives make appropriate sourcing decisions.

Finally, IT outsourcing risk also occurs when managers, having signed the contract, do not manage across the outsourcing life cycle to deliver the results. Cullen et al. (2005) provide details of the necessary management activities over nine phases of the outsourcing life cycle, while Willcocks (2021b) section 4.8, pp.104–12 provides much more detail, but here is a summary of the findings that suggests eight management steps to outsourcing health:

- mitigate risks
- evolve capability to manage larger, more complex outsourcing over time
- develop sourcing strategy
- build retained capabilities
- establish the right relationships with suppliers
- check supplier capabilities
- manage across the life cycle (see Cullen et al., 2005, for more details)
- measure performance with business metrics.

Activity

Read Willcocks (2021b), Chapter 4, sections 4.7 and 4.8.

1. Ignoring location attractiveness, make a list of the factors you would consider when deciding whether or not to outsource software development.
2. You are the CIO of a multinational bank. You are asked to review your IT portfolio. This consists of desktop maintenance, mainframe processing, internet banking, software development, IT security, customer relationship management systems, ERP systems delivering accounting, HR and procurement applications, and branch systems. What do you outsource, on what basis, and what do you keep in-house? Explain your decisions.

12.7 Key concepts

The key concepts in this chapter are:

- global sourcing
- production
- logistics
- offshoring
- outsourcing
- make-or-buy decisions
- location attractiveness
- nearshoring
- business and IT services
- services: sourcing decisions and risks
- managing across the services outsourcing life cycle.

12.8 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- outline the trends towards outsourcing, global sourcing and offshoring
- discuss the benefits and challenges of global sourcing of production for the company
- list the major factors that influence production location
- describe the components of make-or-buy decision making and be able to apply the concept to real case decisions
- list the strategies for minimising risk in global sourcing
- define the nature of offshoring and its challenges to business organisations, and identify challenges and make recommendations on offshoring strategy
- describe and be able to apply a framework for identifying global location attractiveness
- for services, make business services and IT sourcing decisions in a global context, while assessing and reducing the risks in offshoring
- for services, define the principles of managing across the business services and IT outsourcing life cycle.

12.9 Test your knowledge and understanding

Read the case study 'Hewlett-Packard in Singapore' (VLE Chapter 12). To further explore Hewlett-Packard's international operations, go to the company's website at www.hp.com

The company initially used the plant as a low-cost location to manufacture electronic components. Later, entire products were produced in Singapore. Later still, the Singapore plant was involved not only in production but also in product design. Today, the plant is an important part of Hewlett-Packard's global network responsible for manufacturing and also product development and design. Ask yourself:

a. What factors were important in Hewlett-Packard's initial decision to open a plant in Singapore? How did these factors contribute to the decision to increase responsibilities at the Singapore plant?

b. In 2011, the Singapore plant was considered to be a 'lead plant' for Hewlett-Packard. How can the company help the plant continue to be a key component in Hewlett-Packard's global network? Look up recent events online.

c. Make revision notes on the advantages and disadvantages to a company of outsourcing production to a foreign location. To help you, read Willcocks (2021b) Chapter 4, pp.85–98, sections 4.2 to 4.5.

12.10 Sample examination question

'Information Technology (IT) outsourcing has become a global trend, but presents a range of risks as well as opportunities for an international business.' In the light of this statement, and using illustrative examples throughout:

a. Define the terms 'information technology' and 'outsourcing'

b. Explain why an international business would want to outsource its IT, including the reasons why offshore IT outsourcing may be attractive.

c. Discuss the major risks and challenges an international business faces when outsourcing, and the distinctive risks and challenges when undertaking offshore outsourcing.

d. In recent years, a noticeable trend has been 'backsourcing', that is bringing offshored IT back 'in-house' – under internal management and control. What do you think explains this trend?

Chapter 13: Global information systems management

13.1 Introduction

While there are many examples of globalising companies, the reality is that, as Chapters 1 and 7 made clear, many businesses competing in foreign markets are not acting as truly globalised organisations. Instead, they have set out on a globalising journey. In this journey, they must apply business environmental analysis to understand drivers and challenges (see Chapters 2, 3 and 7). They need to arrive at a business strategy (Chapters 7 and 8) for the global context and sector(s) they are operating in. They need to establish an organisation structure that fits that strategy (see Chapter 11), and organise their management and business processes (see Chapters 11, 12 and 14). Critically, they need to create the technology strategy and platform and that fits and supports the business's strategic direction. All this is summarised in Willcocks (2021b) Chapter 5, p.116, figure 1.1. Look at this now. This shows how alignment of the five components – environment, strategy, structure, processes and technology – is critical.

The globalising business seeks to follow a path that emphasises new sources of local innovation while realising opportunities for efficiencies in local and global operations. Remember Chapter 7 of this guide? Such a business is thus challenged with managing its information and technology resources in a way that maximises both business flexibility and business standardisation. Business flexibility is the ability to tailor products, services and business processes to local markets to create customer value. Business standardisation is the concurrent need to find common ways of gaining business process efficiencies across the company to reduce working capital and to leverage human knowledge across business and product units for organisational learning.

In this chapter we focus on managing global information systems. This is a vast subject and, to be frank, not well covered in the international business literature. This makes Willcocks (2021b) essential reading. While this chapter gives an overview and a guide to understanding global information systems management, we will focus primarily on two critical challenges for globalising businesses: business–IT alignment from strategy to operations, and IT enterprise architecture. These are covered in much more detail in Willcocks (2021b) Chapter 5.

This subject is very big; it is also becoming very important to international business. Therefore we have separated off global sourcing of IT and IT-enabled business services, to give it more detailed treatment, and placed this in Chapter 12 (on Global sourcing). The rise of global digital systems was accelerated as a result of the 2020–21 pandemic and economic crises. We also treat this subject separately, in the detail it deserves, in Chapter 16 of this guide.

13.1.1 Aims of the chapter

The aims of this chapter are to:

- establish the importance of business and IT strategy alignment and illustrate how this is achieved at the levels of providing direction,

establishing organisation, managing IS development and project management, and delivering ongoing operations and infrastructure
- introduce four types of enterprise IT architecture, each fitting with either a multinational (localisation), international, transnational or global approach to business strategy.

13.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- assess the importance and dimensions of aligning IT strategy, organisation, development, projects and operations with business purpose and business strategy
- define global enterprise IT architecture and work with four enterprise architecture models in making decisions about fit with international business strategy
- explain and discuss the strengths and weaknesses of the multinational, global, transnational and international types of enterprise IT architecture
- make recommendations on the key success factors in building and transitioning enterprise IT architectures over time.

13.1.3 Essential reading

Kettinger, W., D. Marchand and J. Davis 'Designing enterprise IT architectures to optimise flexibility and standardisation in global business', *MISQ Executive* 9(2) 2010, pp.95–113.

Willcocks, L. *Global business: management.* (Stratford-upon-Avon: SB Publishing, 2021b) Chapter 5.

13.1.4 Further reading

Fonstad, N. and M. Subramani 'Building enterprise alignment: a case study', *MISQ Executive* 8(1) 2009, pp.31–41.

Laudon, K. and J. Laudon *Management information systems: managing the digital firm*. (Harlow: Pearson, 2020) 16th edition. Especially Chapter 15, 'Managing global systems'.

Luftman, J., H. Zadeh, B. Derkesen et al. 'Key information technology and management issues 2011–2012: an international study', *Journal of Information Technology* 27(3) 2012, pp.198–212.

Shpilberg, D., S. Berez, R. Puryear, et al. 'Avoiding the alignment trap in information technology', *Sloan Management Review* 49(1) 2007, pp.50–58.

Willcocks, L., P. Petherbridge and N. Olson *Making IT count: strategy, delivery, infrastructure*. (Oxford: Butterworth-Heinemann, 2002) Chapter 2.

13.1.5 References cited

Bartlett, C. and S. Ghoshal *Managing across borders: the transnational solution*. (Boston: Harvard Business School Press, 1998).

Earl, M. (ed.) *Information management: the organisational dimension*. (Oxford: Oxford University Press, 1996).

Luftman, G., R. Dwivedi, B. Derkesen and M. Sanatana 'Influential IT management trends: an international study', *Journal of Information Technology* 30(3) 2015, pp.293–305.

Nolan, R. and W. McFarlan, R.L. Nolan and F.W. McFarlan 'Information technology and the board of directors', *Harvard Business Review* 83(10) 2005, pp.96–106.

Ross, J. 'Creating a strategic IT architecture competence: learning in stages', *MISQ Executive* 2(1) 2003, pp.31–43.

Ross, J., C. Beath, and M. Mocker *Designed for digital: how to architect your business for sustained success*. (Boston: The MIT Press, 2019).

Weill, P., M. Subramani and M. Broadbent 'Building IT infrastructure for strategic agility', *Sloan Management Review* 44(1) 2002, pp.57–65.

13.1.6 Synopsis of chapter content

Achieving business and IT alignment; IT strategy; IT organisation; IT operations; IT development and project management; IT operations; managing global enterprise IT architecture; the multinational (localisation) approach; the international approach; the transnational approach; the global standardisation approach; enterprise IT architecture success factors.

13.2 Business and IT alignment

According to Willcocks (2021b), information technology (IT) represents the convergence of electronics, computing information and media technologies and capabilities. IT consists of equipment – hardware, software, tools; techniques – methods, procedures, skills and routines; and people ('liveware'). In the modern business context, IT supports a business information system – a relatively organised combination of technologies, people, knowledge, data and information utilised for business purpose.

Willcocks (2021b) defines alignment as the process by which those responsible for managing information technology (IT) and stakeholders from the rest of a company work together to achieve long-term business value. As you look through the cases in this chapter, you will see that the alignment of technology capability with global business purpose is a never-ending struggle for just about all businesses. Business environments are dynamic; business purposes constantly change in the face of competition and consumer demand; and technologies advance rapidly. Business users worldwide are demanding and increasingly IT literate. The senior IT manager, traditionally called CIO (chief information officer), not only has to manage the company's legacy systems, but must decide when to introduce and how to integrate the new technologies constantly arriving from suppliers. The CIO also has to make decisions on whether or not to outsource all or some of the firm's IT activities and assets. In fact, the job is often so difficult that some organisations have split off tasks and created additional roles such as chief digital officer, chief innovation officer, chief technology officer and chief data officer.

As one example of challenge, consider the changing technology. Luftman et al. (2015) found the top technology applications on the CIOs' radar in 2015 were Analytics/business intelligence, Cloud computing, ERP systems, CRM systems, Security technologies. By 2021 robotic process, cognitive automation and artificial intelligence (AI) had become much more high profile, and cyber-security was so challenging as to fuel an exponentially growing software industry. Moreover, other digital technologies were increasingly coming on-stream, a process widely called 'digital transformation' (see Chapter 16). Much of this was accelerated as a part consequence of the pandemic and economic crisis of 2020–21.

Activity

1. Read the case study 'W.R. Grace and information systems' (VLE Chapter 13). W.R. Grace is a world leader in specialised chemical and construction products. W.R. Grace consolidated its general ledger system successfully using an SAP General Ledger application. Reading the case, you will see that even using a package can be a major

global implementation challenge. IT outsourcing can be a partial solution, but IT service suppliers also need attention – they need to be located within overall business and IT strategy, selected, controlled and managed. Managing global information systems presents major challenges.

2. Read Willcocks (2021b) Chapter 5, pp.118–19 and make a note of the major concerns of CIOs, to get a feel for the challenges.

How to deal with these challenges? The answer is alignment with the business from the strategy level all the way through to organisation, development, delivery and running operations. Willcocks (2021b) Chapter 5, pp.119–29 is useful here in pulling together from many sources 15 practices that define 'best practice' in information systems (IS) management. These are organised into four practice areas, which we will look at briefly:

1. **Providing direction – strategy formulation and the strategic use of IT.**

   Here Willcocks (2021b) suggests three main practices:

   - **Practice 1**: A clear business strategy is needed, to guide technology strategy.
   - **Practice 2**: Three sub-strategies are needed for technology. These are an information technology, an information systems, and an information and technology governance strategy. These are illustrated and discussed in detail in Willcocks (2021b) Chapter 5, figure 5.2, pp.119–21.
   - **Practice 3**: Align business and IT/IS strategy. There are several frameworks that help this alignment process. These are worth knowing! One involves navigating through three distracting domains of IT – hype, capability, useful IT – and ignoring them, to focus on the fourth critical domain of strategic IT applications – the relatively few IT applications that produce exceptional business value (see Willcocks, 2021b, pp.121–22).

Another practical framework is the IT strategic impact grid developed by Nolan and McFarlan (see Willcocks, 2021b, figure 5.4, p.123). The grid suggests that organisations have two essential needs from IT – reliability and new competitive capability. This suggests that you need a portfolio of IT systems. Some will be defensive and of varying degrees of importance to the organisation ('Factory' and 'Support' systems). Others will be offensive competitively speaking ('Strategic' and 'Turnaround' systems. Willcocks (2021b) pp.122–23 provides a good explanation of these types of systems and why they are needed.

Finally there is Earl's multiple methodologies framework, which suggests that managers need to have three ways of developing business-IT strategic alignment. One is a 'top-down' approach starting with business strategy and working out the IT needed to deliver it. Another is a 'bottom-up' approach that looks at existing systems and selects those that will deliver most business value, and those that need to be dropped. The third is an 'inside-out' approach which looks for business opportunities in the competitive landscape for which existing and new technologies can be leveraged for business advantage. The framework is nicely summarised in Willcocks (2021b) Chapter 5, figure 5.5 and pp.123–24.

2. **Establishing the IT organisation – structure, staffing and capabilities.**

   Here Willcocks (2021b) suggests a further two practices:

   - **Practice 4**: Evolve the maturity of the IT function. This takes it, over time, from a simple, technically competent IT service organisation, to one that is strategic partner with the business that can manage and make use of strategic IT. The evolved mature IT function is then capable of business innovation with IT in collaboration with business units and external IT service organisations.
   - **Practice 5**: Put in place an IT organisation structure that reflects the organisation as whole. The choices are between centralised, decentralised or federated. There are advantages and disadvantages of having a centralised IT function, or a decentralised IT function. A federated IT organisation tries to minimise the disadvantages by having elements of both centralisation and decentralisation. Willcocks (2021b) Chapter 5, pp.124–126, figure 5.6 discusses and illustrates the advantages and disadvantages of each option.

3. **Managing IT development and project management.**

   Here Willcocks (2021b) Chapter 5, p.126 suggests four further practices:

   - **Practice 6**: Keep project management in-house as a core organisational capability (see Chapter 8 and the resource-based approach).
   - **Practice 7**: Only outsource 'mature' tasks. This refers to activities that are well understood, stable, and for which a detailed contract can be written.
   - **Practice 8**: Use multi-functional groups for business innovation tasks where the means are uncertain, and the objectives cannot be well defined. This is often the case when trying to develop new technologies, for example blockchain, robotic process automation, augmented reality, and apply them to a business.
   - **Practice 9**: Adopt prototyping and 'timebox' approaches to projects. This will be discussed in detail in Chapter 15 of this guide.

4. **Delivering ongoing operations and infrastructure.**

   OK, six more practices remain, and then you are an IT expert!

   - **Practice 10**: Retain nine core capabilities to keep control of your IT function. This practice relates again to a resource-based approach. With these capabilities in-house, in principle you can outsource all other IT activities. Note the different roles these capabilities play whether facing the business, dealing mainly with technology, or dealing mainly with external suppliers, or just being integrating or governance roles (see Willcocks (2021b) Chapter 5, pp.127–28 and figure 5.7).
   - **Practice 11**: Staff these nine core IT capabilities with a small group of high performers.
   - **Practice 12**: Put in place the capabilities for running and delivering a sourcing strategy before undertaking large-scale outsourcing projects.

- **Practice 13**: Keep non-core IT activities in-house if they are cheaper and/or done better there.
- **Practice 14**: Ensure IT staff are business focused, and put business imperatives before their understandable fascination with the technology.
- **Practice 15**: Treat infrastructure as much more than an IT architecture plus a technology platform.

Activity

1. At this point it is well worth re-reading Willcocks (2021b) section 5.2, pp.117–29. It is a lot to take in, but try answering the following questions to test your understanding:
   a. Can you describe three frameworks that are useful for achieving business-IT strategy alignment?
   b. Why would you adopt a federated IT organisation?
   c. We are going to look at project management in detail in Chapter 15. But for now, why do you think software development should be largely an in-house project, and why should project management itself be an in-house core capability?
   d. Why do nine, core IT capabilities need to be retained in-house?
2. Read the case study '3M develops a global IT architecture' (VLE Chapter 13). Now answer these questions:
   a. Make notes on what 3M inherited in terms of information systems.
   b. Describe briefly the actions taken to try to achieve alignment between business strategy and the technology platform.
   c. Draw a detailed diagram of the alignment actually achieved. The alignment model is: business challenges–management–organisation–technology–information systems–business solutions.
   d. Make notes on how the 15 practices from Willcocks (2021b) Chapter 5, section 5.2, and apply to the 3M case to assess 3M's performance on IS management.

13.3 Managing global enterprise IT architecture

The globalising business must be thoroughly competent at the IS management practices described above if it is to leverage its enterprise IT architecture effectively. At the core of a globalising organisation's information capabilities is its enterprise IT architecture, defined as the organising logic for applications, data and infrastructure technologies, as captured in a set of policies and technical choices, intended to enable the company's business strategy (Ross, 2003; Ross, Beath and Mocker, 2019).

Enterprise IT architecture comprises two aspects:

- **Enterprise systems (ESs)**, which include the horizontal and vertical systems that manage the information and knowledge related to the core global business processes, such as order fulfilment, materials and service acquisition, customer acquisition and retention, manufacturing and distribution. ESs tend to span functional boundaries and even cross-organisational boundaries as they tie together supply chain, partner and customer relationships.
- **IT infrastructure** comprises the information, people and IT practices required for planning and operating the hardware, software and networks that enable the ESs. IT is sometimes described as 'everything except the applications'.

Hopefully your reading of the 3M case makes it clear why IT enterprise architecture is critical for the globalising business. We are going to use the article by Kettinger et al. (2010) to clarify types of enterprise IT architecture and how they fit with the international business strategies we discussed in Chapter 7.

We know from Chapter 7 that global competitiveness increasingly requires optimisation of both business flexibility and business standardisation. Bartlett and Ghoshal (1998) identify four alternative approaches to operating globally. Bear in mind that their typology is slightly different from the one we use in the rest of this chapter.

- The **multinational approach** seeks to establish and maximise business flexibility around the world, managing a portfolio of multiple distinct business units (BUs).
- The **international approach** introduces business standardisation for adapting and transferring parent company knowledge to foreign markets while maintaining business flexibility, often in terms of regional infrastructure support.
- The **transnational approach** further leverages regionalisation of processes to create business standardisation in the core business processes and establishes BUs as strategic partners that must exchange knowledge and capabilities across the entire company.
- The **global approach** treats the world market as an integrated whole, maximising business standardisation while maintaining needed business flexibility for competing globally.

These approaches do not form a rigid stage model where companies start out as multinationals and gradually evolve to the global approach. Rather, in some situations where a company's customer value proposition does not vary considerably worldwide and it possesses the capability to deliver the needed value to its customers worldwide, a company can move directly to the global approach. But this rarely happens. Instead, companies typically must choose one of the other three approaches that best fits their immediate needs and capabilities and then gradually evolve from that approach towards the global approach.

The enterprise IT architecture designs discussed below seek to optimise the specific mix needed of business flexibility and business standardisation for a company operating internationally.

Activity

Read the article by Kettinger et al. (2010) pp.95–105 and decide for yourself how the four business strategies fit with the international, localisation, global standardisation and transnational strategies described in Chapter 7.

13.4 Enterprise IT architecture for the 'multinational' (localisation) approach

The enterprise IT architecture for the 'multinational' approach provides flexible ESs and IT infrastructure country by country and business unit by business unit. This is very similar to the localisation strategy we described in Chapter 7. In many ways, this enterprise IT architecture is a throwback to the pre-IT, high-coordination-cost era when the only way to meet local needs was to cut the apron strings and decentralise information management decision rights to local managers.

The strengths of this are:

- Local responsiveness: Local deployment of IT resources for delivering applications tailored to each BU's unique needs provides the required business flexibility to deliver maximum value to the customer and growing the business locally, uninhibited by corporate interference.

The weaknesses are:

- Duplication: The emphasis on business flexibility leads to duplicate ES implementations across BUs.
- There are substantially higher operating costs across the company.

Activity

Look at the case study 'ABB and a "multinational" approach' (VLE Chapter 13), then answer these questions:

1. Why did ABB adopt this approach in the 1990s? What were its strengths?
2. Do you think ABB had to change its strategy and architecture in the 2000s? Why and in what ways?

Now read Kettinger et al (2010) pp.105, 106 and 109 and the difficulties ABB experienced transitioning, and what happened next.

13.5 Enterprise IT architecture for the 'international' approach

The defining characteristics of the enterprise IT architecture for the 'international' approach are regionally based shared services for IT infrastructure with flexible, country-driven customisation of enterprise systems (ESs). The enterprise IT architecture for the 'international' approach attempts to leverage parent-company IT infrastructure resources to gain cost efficiencies within local BUs, while still fostering sense-and-respond capabilities at the local level. This fits with the international approach described in Chapter 7.

The impetus for moving from the multinational to the international approach often comes from corporate leaders who view the IT costs of BUs as unmanaged and unnecessarily high. Headquarters typically appoints senior IT managers at the corporate and/or regional level to oversee IT infrastructure decisions: developing networking standards, limiting technology choices across the company and reducing IT infrastructure costs. In addition, the corporate office often introduces standards for information sharing and access, although much of the transactional data is still embedded in the local systems of each BU.

With the international approach, regional IT directors typically report to headquarters, but they are rarely able to compel local BU managers to adhere to decisions with which they disagree.

The strengths of this are that the shared IT infrastructure services of the enterprise IT architecture for the 'international' approach offer multiple advantages:

- Smaller markets and/or underdeveloped regions gain the ability to share a more robust IT infrastructure than the local economy and knowledge/skill base would allow.
- Some companies manage to reduce the overall costs of IT operations by consolidating data centres and economising on networks.

- Companies are better able to build awareness about best practices that can be shared and voluntarily adopted by local BUs.

The weaknesses of this are:

- The development of IT standards and policies is driven by committees of BU managers and corporate staff, which means long decision cycles.
- While there are cost benefits from having a regionally standardised IT infrastructure, similar savings are typically not realised with standardised ESs unless they include back-office applications.
- Common systems often lack ownership and buy-in at the local level.
- Because the use of shared services is optional, incompatibility and duplication of systems can still increase operating costs.
- Data are still embedded in local applications, limiting best-practice sharing and organisational learning.

The move to shared IT infrastructure services, while maintaining business flexibility, offers an organisation moving to the international approach the potential to achieve cost efficiencies and information sharing beyond those with the multinational approach.

Activity

Read the Citigroup CEEMEA case in Willcocks (2021b) Chapter 5, pp.133–34, section 5.5 and then answer the following questions.

1. Why did Citigroup move to an 'international' approach?
2. Why was there an increasing move towards standardisation?

13.6 Enterprise IT architecture for the 'transnational' approach

By now, you should have come to the conclusion that what Kettinger et al. (2010) call a 'transnational' strategy is, more or less, the transnational strategy of Chapter 7 of this guide. Try to bear this in mind in what follows. The goal of the enterprise IT architecture for the 'transnational' approach is a corporate-wide, standard global IT infrastructure with a transnational business application environment. With Kettinger et al.'s 'transnational' approach, the organisation finds ways to exploit and accelerate the convergence of local preferences by educating heterogeneous local market segments about common value propositions and by developing products that can be sold and serviced regionally or worldwide. In addition to IT infrastructure standards, ES front-office and back-office process standards are established.

To succeed with the transnational approach, policy decisions often involve negotiations between global product managers pushing for increased business standardisation and local managers advocating the ability to modify products and services to deliver maximum value to local market segments. In essence, ES decisions are handled through a managed consensus. Open debate is encouraged up to a point, after which a top-down decision is made and local/regional BU managers are expected to implement corporate directives. Ultimately, corporate IT resources are redirected to build a standardised IT infrastructure and information sharing tied to the company's core processes becomes mandatory.

Activity

Read the CHEP case in Willcocks (2021b) Chapter 5, pp.134–35, Section 5.6 and then answer the following questions:

1. Why did CHEP move to the 'transnational' approach?
2. What are the potential disadvantages of this approach to enterprise IT architecture? Hint: you might like to refer back to Chapter 7 here and look at the disadvantages of the global standardisation strategy.

13.7 Enterprise IT architecture for the 'global' (global standardisation) approach

This represents what we called in Chapter 7 the 'global standardisation' strategy. When customers' product and service value propositions do not vary significantly worldwide, and the mechanisms required to deliver that value are similarly invariant, the globalising company can seek to enforce a global corporate-driven IT strategy across all business units. The enterprise IT architecture for the global approach fosters information capabilities that are globally scaled and developed at the centre of the organisation. With this architecture, companies are able to establish very strong top-down cultures and carefully measure customer satisfaction to ensure success. While managers in companies adopting the global approach recognise they must sell to local markets, they seek, as much as possible, to design and manage the enterprise processes and IT architecture in a standardised manner globally.

Strengths:

- The ability to create tight alignment between business strategy and the IT deployed worldwide.
- Speed and effectiveness of doing business globally is facilitated by the worldwide IT infrastructure, common business systems and modularised solutions that work well with the enterprise's rationalised data model but that can be customised for local information presentation and use front- and back-office information sharing throughout the enterprise allows the organisation to learn and implement best practices worldwide.
- Systems are implemented only once rather than in every region or country, saving substantial money and time.

Weaknesses:

- Global standardisation can be problematic if business conditions or markets change very rapidly and the global business model is not capable of being reconfigured to accommodate the change.
- A company adopting the global approach must be particularly skilful in sensing new business trends and have strong lines of communication with local operations.
- Local customers may reject 'one-size-fits-all' regional or global product and service delivery. Businesses must guard against an overly rigid enterprise IT architecture that undermines needed business flexibility.

We have described above the design of enterprise IT architectures that optimise business flexibility and business standardisation in the context of globalisation.

Activity

Willcocks (2021b) Chapter 5, pp.136–37, section 5.7 revisits the CEMEX case (VLE Chapter 7). Read this case again and then answer these questions.

1. Why did CEMEX adopt the global approach?
2. What do you see as its strengths and weaknesses for CEMEX?
3. What was the role of IT in supporting CEMEX's business strategy at different stages of its evolution?

Read Willcocks (2021b) Chapter 5, pp.131–40, sections 5.4 to 5.8 and then answer the following questions.

1. Make notes on the strengths and weaknesses of the four different approaches to enterprise IT architecture, noting case examples.
2. Make notes on the nine key success factors for the globalising journey, again using case examples to illustrate the points you make.

13.8 Key concepts

The key concepts in this chapter are:

- business–IT alignment
- IT organisation
- IS development and project management
- Core IT capabilities
- IT operations
- enterprise IT architecture
- IT infrastructure
- multinational (localisation) approach to enterprise architecture
- transnational approach to enterprise architecture
- international approach to enterprise architecture
- global (standardisation) approach to enterprise architecture.

13.9 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- assess the importance and dimensions of aligning IT strategy, organisation, development, projects and operations with business purpose and business strategy
- define global enterprise IT architecture and work with four enterprise architecture models in making decisions about fit with international business strategy
- explain and discuss the strengths and weaknesses of the multinational, global, transnational and international types of enterprise IT architecture
- make recommendations on the key success factors in building and transitioning enterprise IT architectures over time.

13.10 Test your knowledge and understanding

Have a look at the following video on 'Business-IT Alignment and Enterprise Architecture':

www.youtube.com/watch?v=Rrn1szu_Ft4&t=345s

a. Make notes on the Henderson and Venkatraman alignment model.

b. What is the new view of enterprise architecture?

13.11 Sample examination question

An international business is now highly dependent on its IT enterprise architecture. Answer the following:

1. What is enterprise IT architecture?
2. Explain the different approaches to global enterprise IT architecture and assess their strengths and weaknesses.
3. What are the challenges in transitioning from one enterprise IT architecture to another?
4. What principles make managing enterprise IT architecture effective?

Chapter 14: International dimensions of human resource management

14.1 Introduction

Human resource management (HRM) refers to the activities an organisation carries out to utilise its human resources effectively. These activities include determining the overall human resource strategy, how a company should be staffed, how managers will be evaluated, how management development will be achieved, what compensation packages will look like, and how the company will manage its relationship with labour. Look at Willcocks (2021b) p.162, figure 7.1. This shows the 10 activities and challenges covered by human resource management. In this chapter we will not be able to cover all these areas and their related issues in depth. We have also dealt with a number of other relevant issues – workforce diversity, corporate social responsibility and managing culture – in earlier chapters. In this chapter we give particular attention to the role of expatriate managers, and discuss in detail the HRM policies and challenges that arise. More broadly, we will look at the international dimensions of the following major areas:

- determining the company's human resource strategy
- staffing policy
- expatriate staff: challenges and best practices
- performance evaluation
- training and management development
- compensation
- labour relations
- IHRM prospects.

As firms have become more dependent on foreign markets, both as a source of both revenue and low-cost labour and materials, international human resource strategy has become increasingly important for them. Human resource management tends to be more complex in international companies as compared to domestic companies because of differences in labour markets, culture, legal systems, economic systems and the many other factors we looked at in Chapters 2 and 3 of this guide.

What is the link between international business strategy and international human resource management (IHRM)? The 2020–21 crisis demonstrated it starkly. As business fell away, strategy changed, often dramatically. Organisations had to reassure staff internationally; organise remote working arrangements; change the basis of payment; adapt to different working hours; maintain stable productivity; learn to collaborate differently; and in many cases stand people down from a full workload – and even make thousands of people redundant. HRM was highly involved in all these activities.

Remember that a company's strategy (see Chapter 7) is implemented through its structure and organisation (see Chapter 11), and if the right structure and organisation are not there, the strategy will not work. But companies also need to ensure that there is a fit between their international business strategy and human resources practices. This gives rise to international human resource management (IHRM), which is the process of selecting, training, developing and compensating personnel in overseas, as well as domestic, positions. IHRM strategy must fit in with and support whichever international strategy and structure is chosen by the company. For example, a company pursuing a localisation strategy needs to be sure that local managers are involved in decision-making. Similarly, a company with a transnational strategy needs to have the means to transfer and disseminate information throughout the company. What staffing policies would support this objective? Through optimal use of a diverse workforce, IHRM can help the company reduce the costs of value creation and add value by better serving international customer needs. IHRM must also determine when to use expatriate managers (citizens of one country working abroad) and deal with questions like who should be sent on foreign assignments, how they should be compensated, how they should be trained and how they should be reoriented when they return home.

The area of IHRM offers major challenges, not least because, as we shall see, MNEs necessarily have diverse workforces and a mix of cultures that need managing. In this chapter we focus on how key areas can be managed.

14.1.1 Aims of the chapter

The aims of this chapter are to:

- introduce different types of human resource management strategies for overseas operations
- focus on the employment of expatriate employees and the challenges their management presents to firms operating internationally
- identify how to recruit, select, train and develop expatriate employees, and the challenges organisations face in these areas
- establish how expatriate employees can be appraised in international business
- describe the different components of international employee compensation packages
- demonstrate the major issues and challenges in the management of labour relations in international settings
- understand the role and challenges of automation when dealing with global workforces
- be alert to the future challenges for IHRM and how they can be handled.

14.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define the term 'international human resource management' and discuss types of human resource strategies in overseas operations
- assess the challenges experienced by expatriate employees and the policies required
- describe the screening and selection issues and criteria used in choosing people for overseas assignments
- relate some of the common types of training and development challenges with personnel who are going, and returning from, overseas

- discuss the main challenges in appraising employee performance in international business
- discuss the common elements of an international compensation package
- explain the major and most typical labour relations issues in the international arena
- assess the challenges and impact of automation and the 2020–21 crises for future IHRM policies.

14.1.3 Essential reading

Willcocks, L. *Global business: management*. (Stratford-upon-Avon: SB Publishing, 2021b) Chapter 7.

14.1.4 References cited

Caligiuri, P., H. De Cieri, D. Minbaeva, A. Verbeke and A. Zimmerman 'International HRM insights for navigating the COVID 19 pandemic: implications for future research and practice', *Journal of International Business Studies* 51 2020, pp.697–713.

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Mendenhall, M. and G. Oddou 'The dimensions of expatriate acculturation: a review', *Academy of Management Review* 10 1985, pp.39–47.

Peng, M. and K. Meyer *International business*. (London: Cengage Learning, 2019) Chapter 16.

Tung, R., 'Selection and training procedures of US, European and Japanese multinationals', *California Management Review* 25 1982 pp.57–71.

14.1.5 Synopsis of chapter content

The nature of international human resources management; types of international staffing policies; managing expatriates – recruitment and selection; expatriate training and development; performance appraisal in international business settings; compensation challenges; labour relations in the global firm; impact of automation on future IHRM; post-2020–21 prospects and responses.

Activity

Read the case study 'IHRM at Coca-Cola' (VLE Chapter 14) then answer the following questions:

1. Does the company have a local perspective on how to conduct human resources management?
2. How does the company choose people for international assignments?
3. Assess the training the company provides for interns.
4. Why is it useful for the company's managers to be fluent in more than one language?

14.2 Staffing policy

A company's staffing policy involves the selection of employees who fit the needs of a specific job and who will be effective at promoting the company's corporate culture – the company's norms and value system. A strong corporate culture can help the company implement its strategy. Therefore General Electric, for example, hires people who not only have the skills necessary for a particular job, but who also have behavioural styles, beliefs and value systems that fit with the company's corporate culture. Peng and Meyer (2019) Chapter 16 point to three main approaches to staffing policy within international businesses:

1. **Ethnocentric approach**: Companies with an ethnocentric approach to staffing fill key management positions with parent country nationals. In the past, this approach was very popular. Companies like Proctor & Gamble, Philips and Matsushita, for example, all had ethnocentric approaches to staffing. Why follow an ethnocentric approach to staffing? It makes sense for companies with an international strategy. Companies that pursue an ethnocentric policy believe that there is a lack of qualified individuals in the host country to fill senior management positions. They also see it as the best way to maintain a unified corporate culture. Many Japanese companies transfer managers to foreign operations for this reason. Value can be created by transferring core competencies to a foreign operation via parent country nationals. But it limits advancement opportunities for host country nationals and can lead to 'cultural myopia' where a company doesn't really understand host country cultural differences and what they mean. If local managers do not see room for advancement, they will be less motivated.
2. **Polycentric approach**: Companies that follow a polycentric approach to staffing recruit host country nationals to manage subsidiaries in their own countries, while parent country nationals fill key slots at headquarters. An advantage of this approach is that it avoids the cultural myopia mentioned above. This, of course, is especially beneficial to a company following a localisation strategy (see Chapter 7). A polycentric approach can also be less expensive to implement because it avoids the cost of expatriate managers. However, a key drawback of the polycentric approach is that it creates a gap between the home country and host country operations. This gap can make it difficult to transfer core competencies, or achieve experience curve or location economies. Companies that follow a polycentric approach often have a hard time shifting to new strategies. Unilever, the UK-based MNE, found this out when it tried to shift to a transnational strategy. The company's subsidiaries had been operating more or less autonomously and resisted pressure to give up that sovereignty (see Chapter 11). Another drawback with a polycentric staffing policy is that host country nationals, because they only have limited opportunities to gain experience outside their own countries, have difficulty progressing beyond senior positions within their own subsidiary.
3. **Geocentric approach**: Between the extremes of the ethnocentric approach and the polycentric approach is the geocentric approach where the best people, regardless of their nationality, are sought for key jobs throughout the organisation. This is consistent with building a strong, unifying culture and informal management network. It makes sense for companies pursuing a global or transnational strategy. It enables the company to make the best use of its human resources. It builds a cadre of international executives who feel at home working in a number of different cultures. These managers can be the first step to building a strong corporate culture. A geocentric staffing policy can also help companies reduce cultural myopia and be more responsive to local markets. Keep in mind, though, that a company might not be able to pursue this strategy if immigration policies limit their ability to hire certain individuals. In the USA and Switzerland, for example,

extensive documentation is needed to hire a foreigner rather than a local citizen. Also, a geocentric strategy can be costly and difficult because of the training and relocation costs involved.

A summary comparison of these three staffing approaches appears in Willcocks (2021b) Chapter 7, p.165, table 7.1. Have a look at this now.

Activity

Read Willcocks (2021b) Chapter 7, pp.160–67, and then answer these questions.

1. Make additional notes on staffing approaches, especially regarding which company uses which approach.
2. Think of a major MNE from your own country. What staffing approach do they have? Why?
3. What are the advantages and disadvantages of using
   a. host country nationals (i.e. local managers)
   b. parent country nationals
   c. third country nationals.
4. Why use short-term or virtual assignments for expatriate managers?

14.3 Expatriate issues and the role of recruitment and selection

Companies that decide to use expatriate managers (i.e. citizens of one country who are working in another country) need to think about how they can help the managers be successful. Why? Because the expatriate failure rate is high. Good recruitment and selection procedures can reduce the risk of failure.

14.3.1 Issues with expatriates

Expatriate failure, or the premature return of an expatriate, is common. Studies over the years, like those of Tung (1982) and Lee (2007), have shown that between 16 and 40 per cent of US expatriates on assignment in other developed countries come home early. About 70 per cent fail to complete their assignments in developing countries. The cost of failure is high – it can cost between $0.25 million and $1 million per employee.

The main reasons for **US expatriate** failure are:

- the inability of an expatriate's spouse to adapt
- the manager's inability to adjust
- other family-related reasons
- the manager's personal or emotional maturity
- the manager's inability to cope with larger overseas responsibilities.

The main reason for **European expatriate** failure is:

- the inability of the manager's spouse to adjust.

The main reasons for **Japanese expatriate** failure are:

- the inability to cope with larger overseas responsibility
- difficulties with the new environment
- personal or emotional problems
- a lack of technical competence
- the inability of a spouse to adjust.

Companies can reduce expatriate failure through improved selection procedures. Mendenhall and Oddou (1985) identified four dimensions that predict expatriate success. These are valid even today:

1. self-orientation: the expatriate's self-esteem, self-confidence and mental well-being
2. others-orientation: the ability to interact effectively with host country nationals
3. perceptual ability: the ability to understand why people of other countries behave the way they do
4. cultural toughness: how well an expatriate adjusts to a particular posting tends to be related to the country of assignment.

Some experts also believe that a global mindset – involving cognitive complexity and a cosmopolitan outlook – is the fundamental attribute of a global manager. This mindset is often acquired early in life from a bicultural family, living in a foreign country or learning a foreign language as a regular part of family life. AstraZeneca, one of the world's largest pharmaceutical companies, and IBM, one of the world's major IT and services companies, are just two examples of companies that promote the notion of a global mindset by encouraging their managers to accept foreign postings and to be comfortable working with people from different countries and cultures. A global mindset is considered by many companies to be the fundamental attribute of a global manager.

Expatriates who have high self-esteem, self-confidence and mental wellbeing are most likely to succeed in foreign assignments. Countries that are perceived to be more similar to an expatriate's home country are usually easier to adapt to. Many US citizens, for example, find it relatively easy to adapt to working in Britain, but not to working in India.

Reiche and Harzing (2019) also suggest that a range of factors can contribute to an expatriate manager's likelihood of adjustment, and success, in an international assignment. The topmost individual factors are the self-motivation and need for achievement and social capability of the manager.

Activity

Look at the case study 'Royal Dutch-Shell and expatriate policies' (VLE Chapter 14), then answer the following questions:

1. What problems did the company experience with recruiting expatriates?
2. What practices did they introduce to deal with these challenges?

14.4 Expatriate training and development

After selecting a manager for a position, the firm needs to implement training and development programmes. Training focuses upon preparing the manager for a specific job. Management development is concerned with developing the skills of the manager over his or her career with the company. This gives the manager a skill set and reinforces organisational culture. Historically, most companies focus more on training than on management development, but recently there has been a realisation that management development can be an essential component in a company's overall strategy.

14.4.1 Training

It is important to clarify for all parties the role the expatriate manager is going to play, so that the right training can be given. Willcocks (2021b, pp.169–70) notes five possible roles – strategist, monitor, ambassador, daily manager and trainer.

Recall that the inability of both the manager and the manager's spouse to adjust to the new environment were among the most common reasons for expatriate failure. Cultural training, language training and practical training can all help to reduce this type of failure. Yet some studies found that only about a third of managers sent on longer term foreign assignments received this type of training. Cultural training is designed to develop an appreciation for the host country culture that should help the manager deal with host country nationals. Given that spouses and other family members also have difficulty adapting to new cultures, the entire family should receive cultural training prior to going on an assignment.

Given that English is the world language of business, is it important to get local language training? Relying exclusively on English limits a manager's ability to interact with host country nationals. Knowing even a little of the local language can help a manager to build rapport with local employees. Practical training helps the manager and his/her family ease into the daily life of the new country. Having a support network of other expatriates can help with this process. But without appropriate training, you can begin to see why there is a high rate of expatriate failure.

Training should include preparing and developing expatriate managers for re-entry (repatriation) into their home country organisation. Once a manager has successfully completed a foreign assignment, a new set of challenges begins. The repatriation process can be just as difficult as going on the assignment in the first place. Sometimes, managers who have had lots of responsibility and autonomy while on assignment will return only to find that they have no clear position waiting for them, or they have a position that doesn't really utilise the new skills they've developed. The home office job lacks the high degree of authority and responsibility that expatriates had in their overseas job, which can lead to a feeling that the company does not value international experience. They may no longer be well known among people at headquarters. Their old job may have been eliminated or drastically changed. Technological advances at headquarters may have rendered their existing skills and knowledge obsolete.

Companies that do not have a programme in place that re-integrates employees into the home country organisation may not be able to capitalise on the knowledge the expatriate gained while on assignment.

14.4.2 Management development

In contrast to management training, recall that management development focused on increasing the overall skills levels of managers through management education and the rotation of managers through various positions in the company. The goal is to develop managers with experience in a variety of areas. As one example among many, Ericsson, the Swedish telecommunications company, transfers people back and forth between headquarters and subsidiaries as part of its management development programme. Management development can be used as a strategic tool to build a strong, unifying culture and an informal management network.

Both of these support a transnational or global standardisation strategy. Management development programmes increase the overall skills levels of managers through ongoing management education and rotations of managers through jobs within the company to give them varied experiences. Management development can be a strategic tool to build a strong unifying culture and informal management network, both of which are supportive of a transnational and global strategy.

Activity

Now read Willcocks (2021) Chapter 7, section 7.3, pp.167–72, including the Monsanto case, and make notes on the following, illustrating the points with examples:

- What are the several possible roles of expatriates?
- What are the key factors in expatriate selection?
- What is culture shock and how can expatriates deal with it?
- What are the main repatriation challenges noted by Willcocks (2021b)?

Also read the case study 'From Dallas To Delhi' (VLE Chapter 14) and answer the following questions:

1. What should the company have done to prepare Sarkar to go to Delhi?
2. What questions should Sarkar now ask the people at headquarters at Dallas?
3. Will Neeli and the children be happy about this move back to the USA? Why?
4. Should Sarkar accept or decline this opportunity? Why?
5. What can the company do to further persuade him to return to Dallas?

14.5 Performance appraisal

Performance appraisal is the evaluation of employee performance for promotion, retention or termination purposes. Who should conduct the appraisal? What should it be based on – the performance of the subsidiary or the performance of the company as a whole? Usually, two groups evaluate expatriate managers, the host country managers and home country managers. However, biases can creep in.

Home country managers tend to rely on hard data when they evaluate expatriates. If a home country manager does not really know what is going on in the subsidiary, the manager may just look at numbers like profitability or market share, which may not give a good picture of what the subsidiary has actually accomplished. Think, for example, of how a simple change in exchange rates might affect a business unit's profit.

Host country managers can be biased towards their own frame of reference. Cultural differences, for example, may affect how they interpret a manager's style and could result in a negative evaluation. Problems with the evaluation process are so bad that a number of studies show over the years that a majority of managers surveyed often think that a foreign assignment could be either detrimental or immaterial to a manager's career. Evaluating expatriates can be especially complex. How can a company do a better job with performance appraisal?

Many managers believe that more weight should be given to an on-site manager's appraisal than to an off-site manager's appraisal. In addition, including a former expatriate who has worked in the same location in the process could minimise bias. Finally, if an on-site manager is responsible for evaluation, the home office should be consulted prior to completing a termination evaluation.

14.6 Compensation

How much should a manager be paid? Should a US citizen working in China be paid the same amount as Chinese colleagues in a similar position, or should they be paid what they earn at home in a similar position? A top US HR executive made an average of $525,923 in the 2005–06 period, compared to $237,697 in Japan and $158,146 in Taiwan. Similar differences exist across all senior management jobs like CEO, CFO, CIO, for example. Is that fair? The question is: should pay be equalised across countries? Many companies have recently moved towards a compensation structure that is based on global standards. This is especially important in companies with a geocentric staffing policy, as suggested in Willcocks (2021b) Chapter 7 p.173, table 7.2.

For example, in 2003 McDonald's revamped its compensation and performance appraisal systems to create a system that is perceived by employees as being more equitable across borders. To achieve this, McDonald's instituted performance and compensation guidelines, yet left room for local managers to customise the programme. However, many companies still set pay according to the prevailing standards in each country, though there has been a definite move in the last 10 years towards more companies developing consistent global compensation structures, at least for their senior managers.

How, then, do companies pay expatriates? There seem to be two main approaches. The first is the **going-rate approach** (i.e. paying expatriates the going rate for comparable positions in a host country). But the going rate differs from country to country.

Most international companies use a **balance sheet approach** to compensation. This method equalises purchasing power across countries so that employees have the same standard of living as they had at home, plus a financial incentive for accepting the foreign assignment – see Willcocks (2021b) Chapter 7, p.174, figure 7.2.

The manager's spending pattern in the home country is protected when the manager moves abroad as their company picks up the additional costs on taxes, housing, goods and services. The good news for the expatriate is that there is also typically a premium and incentives for moving abroad – also paid by the company. The advantages of this approach are that the expatriate has equity between assignments and the approach supports repatriation. But the approach is costly, complex to administer and creates big disparities between expatriate managers and their local peers in the host country. As you can see, the overall package can be substantial and this explains why there is a trend for not sending expatriates abroad unless there is a strong need for specialist skills, and even then the trend is towards as-needed trips rather than long postings. The further trend is towards developing a cadre of internationally mobile executives and phasing out special premiums and incentive payments altogether, and only dealing with cost-of-living issues when designing international pay packages.

Expatriate compensation packages are usually made up of a base salary, a foreign service premium, various allowances, tax differentials and benefits.

- **Base salary**: Expatriate base salaries are generally set in a similar range as the base salaries for similar positions in the home country.
- **Premium**: Expatriates are usually paid some sort of premium for taking on the foreign assignment, ranging from 10 to 30 per cent of the base salary.
- **Allowances**: There are four types of allowances: hardship allowances, housing allowances, cost-of-living allowances and education allowances.
- **Tax**: So that expatriates do not have to pay taxes in both the home country and the host country, companies will usually agree to pay host country taxes if the countries involved do not have a reciprocal tax treaty.

- **Benefits**: Benefits packages are usually paid to make sure the expatriate has similar medical and pension benefits as they would get if they worked at home.

Look at Willcocks (2021b) Chapter 7, p.174, figure 7.2 and pp.174–75 for a more detailed discussion of these points.

Activity

Now re-read Willcocks (2021b) Chapter 7, pp.163–75. Answer the following questions.

1. You have been offered an opportunity for an expatriate assignment for the next three years in India. You have agreed to meet your boss. What will you discuss with them?
2. If you moved from your own country to India how far would formal and informal institutions influence a) your own life and work and b) international human resource management practices your company would need to apply to your case.

14.7 Labour relations

In addition to dealing with the challenges of staffing foreign operations at the management level, companies must also deal with the local labour force. The key issue here is the degree to which organised labour is able to limit the choices available to international companies. Sometimes, labour unions can actually limit a company's ability to follow a transnational or global standardisation strategy. What concerns organised labour?

1. A main concern for labour is that the MNE can essentially counter union bargaining power by threatening to move production to another country. Ford, for example, at one stage threatened to move production elsewhere in Europe when UK workers were particularly active in expressing their dissatisfaction.
2. Labour also worries that MNEs will only bring low-skilled tasks to foreign operations and keep the high-skilled tasks at home. If a company does this, it is easier to switch production to another country.
3. Another concern for labour is that MNEs will try to impose unfamiliar labour practices imported from other countries. Many Japanese companies have tried to bring their labour practices to foreign markets. In the USA, for example, Japanese auto plants are not unionised.

Organised labour has responded to the increased bargaining power of multinational corporations by trying to set up their own international organisations; lobbying for national legislation to restrict multinationals; trying to achieve regulation of multinationals through international organisations such as the United Nations. So far, these efforts have had only limited success.

How can companies approach labour relations? In the past, companies usually delegated labour relations to individual subsidiaries. More recently, companies have been shifting to a centralised approach with the goal of increasing their bargaining power. Companies are realising that how work is organised in a facility can be important to the company's competitive advantage. However, it is also true that to achieve that advantage, it is important for management to have a good relationship with labour.

A company's management of labour relations is also very reliant on country-specific factors and traditions. For example, labour unions have been traditionally strong in Germany. Unions set the pay scale for around 90 per cent of the country's workers, with wages determined by job classifications. Union membership is voluntary, but there is only one union in each major industry. In Japan, union–management relationships are extremely cooperative. Social custom dictates non-confrontational behaviour. In some northern European countries there are traditions of what is called industrial democracy: the legally mandated right of employees to participate in significant management decisions. One example is work councils – groups that consist of both worker and manager representatives that are charged with dealing with matters such as improving company performance, working conditions and job security.

Activity

Consider your own country and a large company you are familiar with, for example, a bank or an insurance or manufacturing company.

1. How are labour relations handled?
2. How different is this from the approaches in Japan, Germany and Denmark?
3. What factors explain these differences?

To consolidate your learning, read Willcocks (2021b) Chapter 7, pp.176–77, noting additional points and illustrative cases.

14.8 IHRM Prospects: some emerging issues

Willcocks (2021b) Chapter 7, pp.177–83, suggests several factors will change how IHRM will be conducted over the next few years. Two major challenges are automation, and the impacts of the 2020–21 pandemic and economic crises.

- Automation and work: Over the next 10 years large global job losses, but also large job gains are forecast as a result of the automation of unskilled and also skilled work. The net loss might be as small as one per cent of the global workforce, but there will be the need for a dramatic shift in skills to meet demand for the different mix of higher-level skills needed in increasingly digitised businesses (see Chapter 16). The skills training agenda for international businesses is urgent and large scale.
- COVID-19 and after: COVID-19 and the economic slowdown created a people-based crisis, both at work and at home. Going forward, IHRM had to recognise and adjust its policies to the volatile, uncertain, complex, and ambiguous environments worldwide described in Chapter 1 of this guide (see also Willcocks, 2021b, Chapter 1).

Caligiuri, P. et al. (2020), note several learning points for managing IHRM after the 2020–21 crisis:

- Different leadership styles are needed in the future, in conditions of uncertainty where employees feel high stress, anxiety, and fear, including fear of losing their jobs.
- Health and safety management needs more attention as related to risk, travel, working in other countries, and corporate social responsibility.
- Rethinking on how global work can be facilitated – for example, virtual work could become an even greater enabler of international business.
- Reconsidering the role of international assignments and alternative ways of optimising work performance.
- Redefining the role of IHRM in building corporate resilience. The learning gained from remote working during 2020–21 may well help here.

Activity

Now read Willcocks (2021b) Chapter 7, pp.177–83, and answer the following questions:

1. What skills do you think will be needed in international workplaces between now and 2020?
2. What trends and factors make IHRM more challenging from 2021 to 2025?
3. How does IHRM need to change to respond to these impending challenges?

14.9 Key concepts

The key concepts in this chapter are:

- human resources management
- ethnocentric, polycentric and geocentric staffing policies
- expatriate work
- repatriation
- recruitment and selection
- training and development
- appraisal
- compensation
- comparative labour relations
- automation
- IHRM prospects.

14.10 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define the term ‘international human resource management’ and discuss types of human resource strategies in overseas operations
- assess the challenges experienced by expatriate employees and the policies required
- describe the screening and selection issues and criteria used in choosing people for overseas assignments
- relate some of the common types of training and development challenges with personnel who are going, and returning from, overseas
- discuss the main challenges in appraising employee performance in international business
- discuss the common elements of an international compensation package
- explain the major, most typical labour relations issues in the international arena
- assess the challenges and impacts of automation and the 2020–21 crisis for future IHRM policies.

14.11 Test your knowledge and understanding

Read the case study 'Managing human resources at EADS' (VLE Chapter 14). Ask yourself:

a. What was the role of expatriates in the EADS merger?

b. Why is cultural knowledge of countries (see Chapter 3) and organisations an important asset for managers to achieve efficiency?

c. How did EADS manage cultural diversity in order to facilitate the integration process?

d. How did HRM contribute to the success of EADS?

14.12 Sample examination question

'International human resource management is a vital activity for many large firms nowadays.'

a. Discuss the three main approaches to staffing policy within international firms.

b. Explain the challenges a firm faces when managing expatriate employees working abroad.

c. How can a firm deal with these challenges and manage expatriates effectively?

Notes

Chapter 15: International project management

15.1 Introduction

As we established in Chapter 1, globalisation trends have become increasingly volatile and complex. International businesses have needed to be ever more alert to delivering major strategic and operational changes in order to remain competitive. This could only be done by leveraging their core project management capabilities in a range of international projects. Examples of such business projects include:

- building factories or service centres abroad or in several countries
- entering new markets
- launching new products/services into selected global markets
- developing and deploying enterprise resource planning (ERP) or customer relationship management systems worldwide
- major cultural change
- infrastructure
- business process reengineering
- digital transformation projects.

The 2020–21 global economic crisis and recovery only added to the list.

Globally, project activity is significant, with for example, 35 per cent of organisations reporting having completed more than 50 projects in 2019 alone. But international projects do not necessarily lead to business success. Many organisations are still more function- and operations-focused than project-focused. Project management is too often not considered a core capability (see Chapter 5 section 5.5 of this guide, on resource-based competition). This, however, has been shifting over the last 10 years, out of necessity, with more projects leading to building of increased project management capability, resulting in slowly improving success rates.

In this chapter, we look at the nature of project and programme management, project methodologies, and what makes international projects more difficult. We look at the critical success factors, then identify the risks in major international projects, and how they can be mitigated and managed.

15.1.1 Aims of the chapter

The aims of this chapter are to:

- introduce project management, programme management and the project management office
- assess the strengths and weaknesses of the main project methodologies for international projects
- identify the ways in which international projects experience distinctive challenges
- establish the critical success factors for international projects
- introduce approaches to risk profiling

- analyse risk in international projects and pinpoint how risks can be mitigated.

15.1.2. Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define project, project and programme management, and project management office
- discuss the major project management methodologies, what each is useful for, and their strengths and weaknesses
- assess the distinctive challenges presented by international projects
- explain the critical practices that make international project management effective
- analyse risk in international projects, using risk-profiling frameworks
- identify how the risks can be mitigated, and international projects managed effectively.

15.1.3 Essential reading

Willcocks, L. *Global business: management*. (Stratford-upon-Avon: SB Publishing, 2021b) Chapter 8.

Nelson, R.R. 'IT project management: infamous failures, classic mistakes, and best practices', *MIS Quarterly Executive* 6(2) 2007.

Abbasi, N., I. Wajid, Z. Iqbal, and F. Zafar 'Project failure case studies and suggestion', *International Journal of Computer Applications* 86(6) 2014, pp.34–39.

15.1.4 Further reading

KPMG, AIPM and IPMA *The future of project management: global outlook*. (Australia: KPMG, 2019).

Ofori, D. 'Project management practices and critical success factors – a developing country perspective', *International Journal of Business and Management* 8(21) 2013, pp.14–31.

The Project Management Institute *A guide to the project management body of knowledge*. (USA: PMI 2017) sixth edition.

15.1.5 References cited

BMG Research *Factors in project success*. (Birmingham: BMG Research, 2014).

Cullen, S., M. Lacity and L. Willcocks *Outsourcing – all you need to know*. (Melbourne, Australia: White Plume, 2016).

Khan, R. and K. Spang *Critical success factors in international projects*. (Prague, Czech Republic: Sixth International IEEE Conference on Data Acquisition and Advanced Computing Systems, 15–17 September, 2011).

Köster, K. *International project management*. (London, UK: Sage Publications, 2009).

Lacity, M. and L. Willcocks *Robotic process automation and risk mitigation: the definitive guide*. (Stratford-upon-Avon, UK: SB Publishing, 2017).

Tharp, J. *Sustainability in project management: practical applications in sustainability integration for effective project management*. (Hershey PA: IGI Global, 2013).

Willcocks, L. *Global business: strategy in context*. (Stratford-upon-Avon, UK: SB Publishing, 2021a).

Willcocks, L., J. Hindle and M. Lacity *Becoming strategic with robotic process automation*. (Stratford-upon-Avon, UK: SB Publishing, 2019).

15.1.6 Synopsis of chapter content

Project and programme management; project management office; methodologies; critical success factors, international projects: differences and challenges; risk profiling and risk management.

15.2 Project and programme management: overview

15.2.1 Projects and project management

A project is a temporary organisation, a unique, transient endeavour focused on achieving specific desired outcomes. This contrasts with routine organisational process and operational work through being temporary, unique and focused on producing something new. In international businesses, projects can vary enormously in size, complexity, scope, content, and time allocated for completion. However, Köster (2009) suggests that each project has three main characteristics in common:

1. They are limited in terms of time, with a clear beginning and end; also in terms of the clearly defined outcomes required.
2. Each project is unique in terms of objectives, context, resources needed, and being a non-routine temporary organisation.
3. As we see in more detail below, being non-routine they involve uncertainty, which creates distinctive risks that need to be managed.

What is project management? A short definition is a 'temporary organisational form (structure, processes, people, technology) that mobilises, controls and directs resources to achieve a set of given goals'. Several phases, called the project (management) life cycle, connect the beginning of a project with its end. Typically, the life cycle consists of four main phases: Initiation; planning; executing/controlling; and completion. The objective of project management is to deliver projects on time, within budget, and to scope, with an agreed quality level (see Willcocks. 2021b, Chapter 8, p.190, figure 8.1). Given that a project has limited resources, this means that project managers have to make serious trade-offs, and prioritise for what can be delivered to what quality (also called scope or schedule) for how much (cost, financials and resources) within what time scale. More recently, Tharp (2013) has introduced a further overlay by adding sustainability to the project management agenda (see Willcocks, 2021b, p.191, figure 8.2). This builds social responsibility, economic viability and environmental soundness into a project's targets.

Projects have stakeholders – essentially individuals, groups, or organisations actively involved in a project, or impacted by project outcomes. You covered stakeholder analysis in Chapter 2, section 3.8.1. Managerially, for efficiency and accountability reasons, it is important to clarify stakeholder roles, authority and responsibilities.

15.2.2 Programme management

We move from project to programme, which we can define as a bundle of projects pursuing a common purpose. According to the Project Management Institute, programme management is 'the centralised, coordinated management of a group of projects to achieve the programme's strategic objectives and benefits'. Projects in a programme are interdependent. They share the same objectives and scarce resources. They typically have a common infrastructure and share a certain set of risks. The programme's objective, though, can be more vague and wider than the rather specific objectives of a single project.

Programmes are essentially managed in the same way as projects. As is true for complex international projects with a long duration, programme objectives might need to be adapted over time. The whole direction and parts of the content of a programme might need adjustments because of environmental changes. Typically, the programme management lifecycle comprises formulation, organisation, deployment appraisal and dissolution.

15.2.3 The project management office (PMO)

The project management office provides a systematic co-ordination and unified handling of key project-related tasks, as an enterprise-wide responsibility. A PMO provides central support to project and programme teams. Remember that a large multinational could have hundreds of projects running at the same time. A PMO helps to standardise approaches, establish common control and measurement techniques, pool resources, provide advice, and be a repository of project management knowledge.

KPMG et al. (2019) found PMOs widespread across industries globally, with 40 per cent of organisations using centralised or enterprise wide project portfolio level PMOs. Sixty-five per cent reported using more focused divisional portfolio or programme/project specific level PMOs.

However, PMOs, at least as operated, have some disadvantages. It can be difficult to gain alignment across different organisational divisions; PMOs are also seen as a cost overhead. Remember also that PMOs are often advisory with few decision-making powers, and are positioned quite low in organisational hierarchies, and so may well lack political clout to get things done.

Activity

Read Willcocks (2021b) Chapter 8, pp.187–93, sections 8.1 and 8.2 then answer the following:

1. Define project, project management, programme management and project management office.
2. Why are these capabilities critical for today's international business?
3. What is the 'iron triangle' in project management, and how has it been extended to meet a sustainability agenda?

15.3 Project management methodologies

A project management methodology is a set of guiding principles and processes for managing a project. A project management methodology serves as a 'conscription device' that enlists and organises participants. It also supports the systematic management of costs, timescales, scope, quality, risks, and identifiable project benefits; provides guiding principles and a common vocabulary; offers frameworks for project governance; and offers methods to structure processes and procedures that keep distributed teams coordinated. There are many project management methodologies! These are dealt with in much detail on Willcocks (2021b) pp.193–200, section 8.2. Let's look quickly at the major ones.

Waterfall

Waterfall methodology is sequential and heavily focused on establishing clear detailed requirements. There is little scope for correction once the project is underway. The Waterfall method is divided into discrete stages. Each stage is self-contained; you end one stage before moving onto another. One advantage is that straightening out design and requirements at the front end saves time and effort retroactively correcting problems at later stages. The model is easy to understand and use. Clear demarcations between the stages helps to organise, divide up, and complete work. The strong focus on documentation makes it easy for multiple and new users to work on the project as needed.

However, the rigidity of this methodology can increase the risk of project delays. The Waterfall approach is also front-heavy, depending greatly on understanding and analysing requirements correctly. Lack of flexibility makes it a poor choice for long and complex projects.

Agile

Agile emerged as a response to disappointments with Waterfall when managing complex projects. This method favours a fast and flexible approach. There is no top-heavy requirements-gathering. Rather, it is iterative with small incremental changes that respond to changing requirements. Agile is a process by which a team can manage a project by breaking it up into several stages and involving constant collaboration with stakeholders and continuous improvement and iteration at every stage.

The advantages of Agile include: flexibility and freedom – with no fixed stages and less focus on initial requirements, the project team can experiment and make incremental changes. You also get regular feedback from stakeholders, enabling progressive corrective changes thus reducing the risk of project failure. However, the lack of a fixed plan makes resource management and scheduling harder, with people and equipment being juggled on a much more ad-hoc basis. Agile is also collaboration-heavy. Without fixed plans, all stakeholders will have to work closely to deliver results. Agile often works with a 'time-box' philosophy, an approach that has been widely applied to all kinds of projects (see Willcocks (2021b) Chapter 8, p.195, section 8.2., figure 8.3.).

This approach has been increasingly adopted worldwide since the 1990s in the face of organisations running into problems applying more traditional methods. The solution has been to break major projects into do-able, smaller 'chunks' with defined high level business deliverables within a 'drop dead' time scale. This requires prototyping, an iterative approach, a multi-disciplinary team, the involvement of users and external customers to create a workable solution then refine it as much as possible within the set time frame. This forces the project team to adopt the 'Pareto 80/20' principle of focusing on the 20 per cent of functionality that delivers 80 per cent of the business value. In an activity below, we will ask you to think of the advantages and disadvantages of such an approach.

Scrum

Scrum is a related contemporary approach. It is not a fully-featured project management methodology. Rather it is an approach to Agile management with a focus on project teams, short 'sprints' and daily stand-up meetings. Here, a small team is led by a Scrum master whose main job is to clear away all obstacles to completing work. Work is done in short cycles called sprints, but the team meets daily to discuss current tasks and roadblocks that need clearing. The Scrum approach places the project team front and centre of the project.

Clearly Scrum embodies time box philosophy and its advantages (including rapid business deliverables). Scrum is even more team-focused since the scrum must manage itself, and allows project leaders to set their own priorities. Can you see problems with this? Scrum is best for highly experienced, disciplined and motivated project teams who can set their own priorities and understand project requirements clearly.

Critical Path Method (CPM)

In the Critical Path Method (CPM), all activities needed to complete the project are categorised within a work breakdown structure. Then you map the projected duration of each activity and the dependencies between them. This helps the planner to map out activities that can be completed simultaneously, and which activities should be completed before others can start. The approach leads to better scheduling of tasks, and is at the heart of most international projects. However, CPM does require planners with real world experience with scheduling. Like Waterfall, CPM is front-heavy – everything needs to be planned at the very start.

PRiSM

PRiSM (Projects integration Sustainable Methods) is a project management methodology developed by Green Project Management Global. The PRiSM approach focuses on accounting for and minimising adverse environmental impacts of the project. It is different from traditional methodologies in that firstly it looks to bring a wider stakeholder group into active involvement in the project. Secondly, the project objectives and planning are seen through additional sustainability criteria involving a social, economic, environmental, ethical, principled and valuable orientation. Thirdly, the methodology extends beyond the end of the project. Instead, it factors in the entire lifecycle of the project post-delivery to maximise sustainability.

PRINCE2

PRINCE2 (Projects IN Controlled Environments) is a structured project management methodology used by the UK government, and internationally. It is a good example of a very structured approach and is described in detail in Willcocks (2021b) Chapter 8, pp.197–200. The methodology is designed to provide clear guidance about the best ways to manage projects. At its best, it helps organisations get strong control over projects and, through attention to detail, drives to secure the anticipated return on investment. PRINCE2 is based on seven major principles, seven themes and seven processes. Have a look at Willcocks (2021b) pp.191–99, section 8.2, for a full listing, but note that you do not need to memorise all these! Reading through you will see that the advantage of PRINCE2 is its recognition that large complex projects are full of risk. It mitigates the risks by comprehensiveness, attention to detail, transparency to all stakeholders, highly structured governance, and clear action plans and decision points for each project stage. This leads to strong, clear communication. Extensive documentation is needed and gives common reference points for multiple project participants present and future. PRINCE2 is also useful for less experienced staff – it is very directive – and where there is high project staff turnover, as new arrivals can pick up what has happened and what needs to happen quite quickly.

However, PRINCE2 has many well-recognised dangers and weaknesses when put into practice. Willcocks (2021b) p.200, figure 8.4 makes a useful comparison between the PRINCE2 and Agile approaches.

Activity

Read Willcocks (2021b) Chapter 8, pp.187–93, sections 8.1 and 8.2 then answer the following:

1. Define project, project management, programme management and project management office.
2. Why are these capabilities critical for today's international business?

Activity

Read Willcocks (2021b), pp.193–200, section 15.3 and answer the following:

1. Under what project circumstances would you use
   a. a Waterfall approach
   b. an Agile approach
   c. a PRiSMapproach
   d. a PRINCE2 methodology?
2. Detail the kinds of weaknesses that can lead to problems with the following methodologies:
   a. Agile
   b. PRINCE2
   c. Scrum.

15.4 What makes for successful projects?

You can find many lists of criteria for domestic and international project success. Based on hundreds of cases, BMG Research (2014), for the Association for Project Management, suggests 12 critical success factors (CSFs) that define the environment in which projects can be delivered successfully:

1. Effective governance.
2. Goals and objectives: clearly specified overall goal recognised by all stakeholders, not in conflict with subsidiary objectives. Project leaders have a clear vision of project outcomes.
3. Commitment to project success: from all parties; lack of commitment recognised early and dealt with; project leadership inspires commitment in others.
4. Capable sponsors.
5. Project planning and review.
6. Secure funding.
7. Supportive organisations.
8. Competent project teams.
9. Engaged user organisations and operators.
10. Aligned supply chain.
11. Proven methods and tools.
12. Appropriate standards.

Note that success factors fall into two broad groups: factors that are descriptive of the environment in which projects take place (such as having secure funding or capable sponsors in place) and others that are more concerned with the actual execution and delivery of projects (such as having competent project teams and aligned supply chains.

Ofori (2013), Khan and Spang (2011) and Köster (2009) reviewed the research literature on project and international project critical success factors. Their findings are listed in Willcocks (2021b) Chapter 8, pp.200–06, section 8.4. and provide useful comparison and extensions. There are quite a lot of overlaps in findings! Thus from her research work, Köster (2009) selected the most relevant factors in international projects as:

- goal commitment of the project and initial clarity of goals
- establishment of smooth communications and supporting infrastructure
- adequate project team capabilities
- consideration of context
- establishing a balance between common methodology and flexibility
- a supportive project culture.

Activity

Read Willcocks (2021b) Chapter 8, pp.200–06, section 8.4. You are not expected to memorise all the findings of these researchers! However, identify some common threads and:

a. Make a list of the top 10 critical success factors for which there seems evidence.
b. Note the critical success factors peculiar to international projects.
c. Read on the VLE Nelson, R.R. 'IT project management: Infamous failures, classic mistakes, and best practices', *MIS Quarterly Executive* 6(2) 2007.
d. Make notes on classic mistakes and note some illustrative examples

15.5 Are international projects different?

Yes! International projects do have distinctive characteristics and challenges. An international project is typically more complex, dynamic, and riskier than a standard project in one country. Often international projects are bigger, because they might need to be applied to several different countries and regions. The international project has to address multiple stakeholders with the added challenges of diversity in national cultures, organisational cultures, functional cultures, languages, and educational backgrounds. The external context of international stakeholders and an international environment with its many different jurisdictions plays a major role in the management of international projects. While domestic and international projects will have many features and challenges in common, there may be major differences in their scope and intensity. Willcocks (2021b) Chapter 8, pp.203–07, section 8.4 suggests that distinctive differences include that:

- International projects are more demanding in terms of the scale of coordination and cooperation. The increased size of international projects intensifies these challenges. As examples, look again at the global IT enterprise architecture projects at Citigroup, CHEPA and CEMEX in Chapter 13.
- International projects' sponsors, champions and project managers have to weigh seriously the impact of distinctive PESTEL and CAGE factors before kick starting the project.
- International projects have unique objectives. For example, Chinese PC-manufacturer Lenovo purchased the Personal Computing Division of IBM (in 2004) to gain access to IBM-technology, the US-market and to benefit from the IBM-brand they could use for five

years. International projects are also unique when it comes to the organisations involved, for example forming international networks, international alliances, and international joint ventures.

- International projects require cultural sensitivity, and local knowledge. Deliverables can be more difficult when faced with different timelines across time zones. At the same time, if work is organised well, time zone differences can be leveraged across different geographies to create continuous workflow.
- International projects need to communicate more intensely and manage expectations with (even) greater clarity. Cullen et al. (2016) found that the key to success in offshoring work has been great explicitness on requirements, timelines, responsibilities, and actions to be performed. As George Bernard Shaw once remarked: 'The single biggest problem in communication is the illusion that it has taken place.' You can understand, then, how detailed methodologies like PRINCE2 came to be developed!
- Managing cross-cultural teams is an integral part of international projects demanding extra awareness and insight.

Köster (2009) adds to this picture. She also mentions unique objectives/ purposes and wider scope and adds risk intensity.

Risk intensity

International projects invariably bear greater risks and uncertainty than other projects. You can already identify many of the reasons. Köster makes the additional point that greater complexity, risk, diversity, and unpredictable dynamics, linked with limited resources all interrelate, thus greatly increasing the level of risk. Many of these factors can be seen at work in the example of Tata Motors, which she cites.

Activity

Read the case of Tata motors in Willcocks (2021b) Chapter 15, pp.206–07, section 8.4.

a. Assess the characteristics of this project that made it international and different from a purely Indian domestic project.

b. Analyse the risks in the project.

15.6 Managing risk in international projects

The Tata Motors case introduced you to the topic of risk in international projects. The Project Management Institute describes project risk as 'an uncertain event or condition that, if it occurs, has a positive or a negative effect on at least one project objective, such as time, cost, scope, or quality'. Risk is about the likelihood of an event together with the size of impact if the risk materialises. Many risks can be anticipated, and project management methodologies are designed to deal with these. Unfortunately, international projects are also often faced with emergent risk. One extreme example that went global was the coronavirus in 2020.

15.6.1 Risk management

Risks need to be planned for as far as possible. Risk management is defined as 'the processes concerned with conducting risk management planning, identification, analysis, responses, and monitoring and control on a project' (PMI, 2017). A typical risk management process, suggested by Köster, is:

- **Identifying risks**: This produces a risk register, which, at this stage, only contains a list of identified risks, including their root causes.
- **Analysing and prioritising risk**: A probability and impact matrix is a widespread tool to perform risk analysis and prioritisation.
- **Performing risk planning**: The identification and prioritisation of risks only make sense if followed up by plans. What to do about serious, likely and less serious and less likely risks? Can risks be totally avoided? If not, how can an organisation reduce their impact? Risk mitigation can be defined as taking steps to reduce adverse effects.

She suggests four risk mitigation strategies:

1. **Risk avoidance**: A risk can be avoided by adequate planning of an international project. For example an Agile approach breaks a large project down into smaller, less risky, more doable projects. This is taking a modular approach. Products can be designed in similar ways. For example, cars these days are built in modular parts.
2. **Risk acceptance**: This is not really a mitigating strategy because accepting a risk does not **reduce** its effect. The most common reason for risk acceptance is that the cost of other risk management options, such as avoidance or limitation, may outweigh the cost of the risk itself. That seemed to be the calculation at BP before the 2010 oil spill in the Gulf of Mexico (see Abbasi et al., 2014 discussed below), but it resulted in huge losses.
3. **Risk transfer**: The risk is passed to another party who now has responsibility for managing the risk, for example, by insurance, guarantees or warranties, or by an outsourcing or offshore agreement. though, as we saw in Chapter 12, this could bring in new risks.
4. **Risk absorption and pooling**: Pool the risk by taking part in a consortium, alliance or joint venture. The strategy is often used in infrastructure projects, and also in new product development projects.

At the same time, risks need to be monitored and controlled. A risk register should be constantly updated and cross-checked with the project status and current developments to find out which risks have occurred. You need to scan the project environment to detect planned or new risks. Also each change request potentially encompasses new risks. The project manager needs to ensure excellent communication regarding the status of risk. How to deal with uncertainty and emergent risks? One answer is to have an adequate project culture, structure, and methodologies that are open to new information, can anticipate environmental changes, and has adaptive processes capable of responding quickly. The right choice of project contract that can adjust to unseen risks can also help.

15.6.2 Risk profiling

A key part of risk management is risk profiling. Willcocks (2021b) provides two frameworks for assessing the riskiness of, and de-risking international projects (Chapter 8 section 8.5, p.211, figure 8.5; p.212, figure 8.6).

When looking at major projects, Willcocks, Hindle and Lacity (2019) found three stand out, easily identifiable, significant risk factors that can be addressed early in any project (see figure 8.5). The first is project management disciplines – do not start an international project without them. Secondly, the larger the size of the project the more risk rises, sometimes exponentially. The third factor is more complex. The higher the level of innovation – for example in product, process, location, use of new partners – the more risky the project. The real danger point is where all three factors score as high risk and interrelate. Reduce the risk, by moving the project to another status on the framework.

Lacity and Willcocks (2017) developed a more detailed risk framework, adapted here for international projects. This risk profiling tool captures a range of real risks related to history and contexts usually missed by more traditional risk profiling approaches that focus on content and process outcomes (see Willcocks, 2021b, figure 8.6). The framework identifies five major risk areas, where risks arise and interrelate:

- **External context** includes PESTEL/CAGE factors, market changes, changing customer tastes, competitive rivalry, complementors, financial system fluctuations, climate change effects, pandemics, natural disasters… all these can produce massive risks for a project.
- **Organisational history of success or failure** can create risks. For example, previous success can lead to over-confidence; earlier failure can create lack of support and engagement with subsequent projects.
- **Internal contexts**: Organisational factors and characteristics such as strategy, structure, reward systems, human resources management, employee relations context, IT Infrastructure and management and changing business needs can be full of dangerous risks.
- **Project content**: These are summarised in Willcocks (2021b) Chapter 8, p.213, figure 8.7 and include size, complexity level of technical uncertainty, how clearly requirements and goals are defined, number of business units and countries involved, and change process factors.
- **Project process**: Major project failure is most frequently related to an over focus on technical efficiency and outcomes, and an under-resourcing of process issues. User training, stability in staffing, experienced project managers and team members, fully engaged business leaders and users are critical factors. Without these, risk accumulates.

15.7 Key concepts

The key concepts in this chapter are:

- project management
- project management office
- programme management
- project management methodologies
- waterfall
- PRiSM
- agile/scrum approaches
- critical path method
- PRINCE2
- critical success factors
- international projects: distinctive challenges
- risk analysis and profiling
- risk management.

15.8 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define project, project and programme management, and project management office
- discuss the major project management methodologies, what each is useful for, and their strengths and weaknesses
- assess the distinctive challenges presented by international projects
- explain the critical practices that make international project management effective
- analyse risk in international projects, using risk-profiling frameworks
- identify how the risks can be mitigated, and international projects managed effectively.

15.9 Test your knowledge and understanding

Read the article on the VLE: Abbasi, N., I. Wajid, Z. Iqbal and F. Zafar 'Project failure case studies and suggestion', *International Journal of Computer Applications* 86(6) 2014 pp.34–39. Answer the following:

a. The article looks at three cases of international project failure: BP oil spill, Chrysler-Fiat merger, the UK's Millenium Dome. Makes notes on the risk incurred in each, and why each project failed.

b. How could each of these projects have been managed more effectively?

15.10 Sample examination question

'In today's business environment, international businesses have to become more project-focused. But international projects are very challenging and replete with risk.'

Answer the following questions:

a. Define project, project management and project management office

b. What is so different about international projects, that makes them so risky? Use illustrative examples to make your points.

c. What approaches to risk management, analysis and profiling can be taken to identify and reduce risks?

Chapter 16: Global digital management

16.1 Introduction

In Chapter 13 we covered the management principles for strategising, developing, and running IT generally. For over 10 years, however, organisations have been becoming more digitalised, meaning that they have been combining existing IT with updated versions and emerging digital technologies to create more digitised platforms and infrastructure. This means that the principles we have detailed still apply, but we need to utilise them carefully, in the light of three developments. Firstly, what are the emerging digital technologies that are going to be the most impactful on international businesses? Secondly, how do we design our IT and businesses to leverage the potential of these and our existing IT? The third question is actually an international project problem – how do we deliver digital transformation?

Throughout we will try to stay faithful to some definitions. There are important distinctions between digitisation, digitalisation and digital transformation. Digitisation sees something non-digital (e.g. a health record, an identity card) represented in, and/or converted into, a digital format that can then be used by a computer system. As a next step digitisation can also be using digital data, extracted from physical analogue sources, to automate business processes and workflows. Digitalisation is a bigger concept and refers to enabling, improving or changing business operations, functions or activities by utilising digital technologies and using digitised data to create management intelligence and actionable knowledge. But digital transformation is an even bigger concept, focusing on the whole organisation, and large-scale change. It sees the transformation of business activities, processes, competencies and models to fully leverage the changes and opportunities of digital technologies and their impacts. Thus digital transformation requires digitalisation to create capabilities, and requires digitisation, because digital data is the core asset here, and can be managed to create information, knowledge, intelligence, action and business model changes. All three – digitisation, digitalisation and digital transformation – are needed to build a digital business. If this sounds rather abstract at this stage, don't worry! In this chapter we have plenty of examples to illustrate what moving to digital business involves.

The general view has been that the 2020–21 pandemic accelerated the adoption of digital technologies, and moves towards digital business. On our view, this trend would continue across the 2021–25 period. The case for these technologies was well made by early 2020s experiences. The technology worked. It provided alternative ways of working in a crisis. It allowed a high degree of virtuality, and all the upsides to that, in a world rendered physically semi-paralysed, albeit temporarily. It would be a foundation for building resilience in the face of increasingly uncertain business environments, and future crises. But when we talk of the technology, in fact there are many emerging digital technologies. We start by looking at the technologies that, in international business usage, will be the most impactful.

This chapter assesses the long-term trends in digitising data, digitalising processes and operations, and how to compete online with digital (and non-digital) products and services. It spotlights how a bigger, holistic change process is needed. We look at the DBS bank case to illustrate digital transformation – the process by which all this can be implemented corporate wide, and internationally, to create a digital business.

16.1.1 Aims of the chapter

The aims of this chapter are to:

- introduce digitisation, digitalisation and digital transformation
- provide an overview of foundational and emerging technologies for building a digital business
- give insight into the key components of a digital business model
- give a detailed understanding of the major, resource-based, building blocks for establishing a digital business
- establish how major change in an international business can be managed through a holistic, systematic change process
- link international project management with change management approaches
- give illustrative examples, as mini and major cases, of successful digital transformation.

16.1.2 Learning outcomes

By the end of this chapter, and having completed the Essential reading and activities, you should be able to:

- define digitisation, digitalisation and digital transformation
- assess the major challenges and critical success factors when building a digital business
- describe and assess 10 major digital technologies used in building digital business
- explain the components of a digital business model, and apply these to assessing actual international businesses
- identify the building blocks of digital business, and analyse an international business's digital transformation progress
- participate in discussions on digital transformation: why, how; and support arguments with international business examples of failure and success.

16.1.3 Essential reading

Willcocks, L. *Global business: management*. (Stratford: SB Publishing, 2021) Chapter 16, and Chapter 15, section 8.6.

16.1.4 Further reading

Ross, J., C. Beath and R. Nelson *The digital operating model: building a componentized organisation*. (MIT Centre For Information Systems Research, Research Briefing, June 2020).

Weill, P. and S. Woerner 'Optimising your digital business model', *Sloan Management Review* Special Collection: 'What's in store for your digital enterprise?', 2014.

16.1.5 References cited

Bughin, J., J. Deakin and B. O'Beirne 'Digital transformation: improving the odds of success', *McKinsey Quarterly* October 2019.

Gurbaxani, V. and D. Dunkle 'Gearing up for successful digital transformation', *MISQ Executive* 18(3) 2019, pp.209–20.

Lacity, M. *Blockchain foundations: for the internet of value*. (Stratford-upon-Avon: SB Publishing, 2020).

Lacity, M. and L. Willcocks *Robotic process and cognitive automation: the next phase.* (Stratford-upon-Avon: SB Publishing, 2018).

McKinsey and Co. *How COVID-19 has pushed companies over the technology tipping point – and transformed business forever.* (McKinsey Digital and Strategy & Corporate Finance Practices, 2020, October).

McKinsey Global Institute *Twenty five years of digitisation: ten insights into how to play it right*. (McKinsey Global Institute Briefing Note, May 2019).

McKinsey Global Institute, *Notes from the AI frontier: modelling the impacts of AI on the world economy*. (McKinsey Global Institute, Briefing Note, 2018, September).

Ross, J., C. Beath and M. Mocker *Designed for digital: how to architect your business for sustained success*. (Boston, USA: The MIT Press, 2019).

Saldhana, T. *Why digital transformations fail*. (Oakland, USA: BK Publishers, 2019).

Wade, M. and J. Shan 'Covid-19 has accelerated digital transformation, but may have made it harder not easier', *MISQ Executive* 2020 19(3) pp.213–20.

Weill, P. and S. Woerner *What's your digital model?* (Boston, USA: HBR Press, 2018).

Willcocks, L. 'COVID-19 may exacerbate the digital divide among businesses', *LSE Business Review* 3 September 2020.

Willcocks, L., J. Hindle and M. Lacity *Becoming strategic with robotic process automation.* (Stratford-upon-Avon: SB Publishing, 2019).

16.1.6 Synopsis of chapter content

Foundational, digital technologies; digital business model; building blocks for a digital business; digital transformation; DBS case; effective change management.

16.2 SMAC/BRAIDA Technologies

So what are the major foundational and emerging digital technologies that will impact business everywhere? According to Willcocks et al. (2019, section 9.2 pp.220–24.) there are at least 10 candidates – figure 16.1. Let's have a brief look at these.

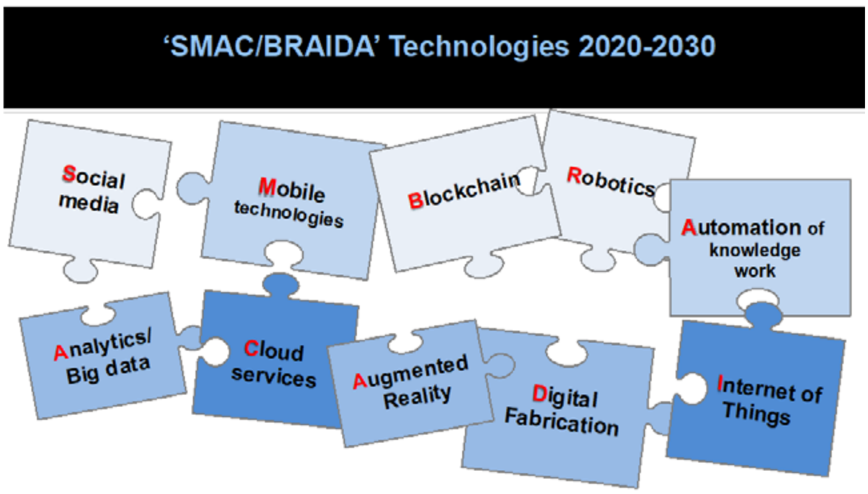

Figure 16.1. SMAC/BRAIDA Technologies 2020–30

- **Social media** are interactive computer-mediated technologies that facilitate the creation or sharing of information, ideas, career interests and other forms of expression via virtual communities and networks. Social media are interactive Web 2.0 internet-based applications.

- **Mobile technology** is used for cellular communication. Mobile technology has evolved rapidly over the past few years. Since the start of this millennium, a standard mobile device has gone from being no more than a simple two-way pager to being a mobile phone, GPS navigation device, an embedded web browser and instant messaging client, and a handheld gaming console.
- **Analytics** is the discovery, interpretation, and communication of meaningful patterns in data. It also entails applying data patterns towards effective decision-making. Especially valuable in areas rich with recorded information, analytics relies on the simultaneous application of statistics, computer programming and operations research to quantify performance.
- **Cloud computing** is the on-demand availability of computer system resources, especially data storage and computing power, without direct management by the user. The term is generally used to describe data centres made available to many users over the internet. Cloud computing is usually bought on a pay per use basis from a cloud vendor, for example Amazon's data services.
- A **blockchain** consists of a growing list of records, called blocks, which are linked using cryptography. Each block contains a cryptographic hash of the previous block, a timestamp, and transaction data. By design, a blockchain is resistant to modification of the data. It has been described as an open, distributed ledger that can record transactions between two parties efficiently and in a verifiable and permanent way (see Lacity, 2020).
- **Robotics** is an interdisciplinary branch of engineering and science that includes mechanical engineering, electronic engineering, information engineering, and computer science. Robotics deals with the design, construction, operation, and use of robots, as well as computer systems for their control, sensory feedback, and information processing.
- **Automation of knowledge work**: This involves software called robotic process automation (RPA), which automates simple repetitive processes by taking structured data and applying prior configured rules to produce a deterministic outcome (i.e. correct answer). It is generically applicable to most business processes. Its limitations mean that it is increasingly complemented and augmented by cognitive automation (CA) software that can process unstructured and structured data, through algorithms (pre-built from training data) to arrive at probabilistic outcomes.
- **Internet of things** (**IoT**) is a system of interrelated computing devices, mechanical and digital machines, including sensors, provided with unique identifiers (UIDs) and the ability to transfer data over a network without requiring human-to-human or human-to-computer interaction. The internet of things has evolved due to the convergence of multiple technologies, real-time analytics, machine learning, commodity sensors, and embedded systems
- **Digital fabrication** and modelling is a design and production process that combines 3D modelling or computing-aided design (CAD) with additive and subtractive manufacturing.
- **Augmented reality** (**AR**) is an interactive experience of a real-world environment where the objects that reside in the real world are enhanced by computer-generated perceptual information, sometimes across multiple sensory modalities.

Looking across these impressive technologies, you will quickly get a sense of their immense potential for being applied in organisations and driving business value, especially when they begin to be used, as some are already, in combination. McKinsey Global Institute (2018, 2019) estimated that applying these technologies could add an additional US$13 trillion to global GDP by 2030.

Activity

Read Willcocks (2019b) section 16.2, pp.220–26. You do not need to know all these technologies in detail! Focus on the ones that are already quite mature, which are listed below, and answer the following:

Write notes on the definitions, and the advantages and disadvantages to an international business of:

a. social media

b. mobile technologies

c. automation of knowledge work

d. cloud services

e. big data and analytics

f. internet of things.

16.3 Developing a digital business model

While the technologies are impressive and improving year on year, there are real challenges in developing and deploying them for business purpose. A starting point is developing what Weill and Woerner (2014) call a digital online business strategy and model. This applies whether the company is a born digital 'pure play' like Amazon, Google, Tencent, Alibaba, Netflix, or a bricks and mortar company in, for example, retail, financial services, pharmaceuticals, manufacturing. Such bricks and mortar companies will have an under-developed online global presence; they need to move more quickly from 'bricks' to 'clicks', but in a way that synergises with rather than displaces the 'bricks'.

What is the case for developing a digital business strategy and model? Willcocks (2021b) Chapter 9, pp.226–29, section 9.3 suggests seven reasons; these are well worth understanding, and we will investigate these in the Activity below.

Weill and Woerner (2014) produce from their research a digital business framework that redirects executive attention towards three things that matter for online effectiveness (see Willcocks, 2021b, p.228, figure 9.3):

- **Content**: What is consumed: information including product and use details; digital products (e.g. e-book, e-saver account, e-movie).
- **Experience**: How it is packaged: the customer experience (e.g. customer interface, customer recommendations, history, speed and ease of interaction with the business).
- **Platform**: How it is delivered: internal business processes, customer data, technology; external public networks, partners.

Amazon, with its retail customer digital business model, along with LexisNexis, provide good examples and are discussed by Willcocks (2021b) Chapter 9, pp.228–29. We will address the examples in the Activity below. An international business does not have to be good at all three areas to be successful! Willcocks (2021b) points to Apple and USAA – both highly successful through focusing particularly on the customer experience component of the model. Clearly, what matters is how well you are geared up for digital business relative to the competition. Gurbaxani and Dunkle (2019) suggest six dimensions of digital preparedness at the enterprise level that position a company for a successful competitive stance:

1. a company's strategic vision
2. alignment of the vision and its investments in digital transformation
3. the suitability of the culture for innovation
4. possession of sufficient intellectual property assets and know-how – software increasingly applied for improving operations, customer understanding, product know-how, and supplier interactions
5. strength of its digital capabilities – availability, depth, and rightness of digital expertise from visioning to innovating, development, delivery and digital operations
6. its history of using digital technologies.

Activity

Read Willcocks (2021b), Chapter 9, pp.226–29, section 9.3, and answer the following:

1. Why is the digital business model of either Amazon or LexisNexis so effective?
2. Explain how Apple and USAA are so successful, despite not having world-class capability in all three of content, experience and platform.
3. What are the dimensions of digital preparedness suggested by Gurbaxani and Dunkle (2019)?

16.4 Building blocks for a digital business

As we learned in Chapter 13, it's not enough to establish the business imperatives technology has to be aligned with. You also need to build capability – resources, change management and execution capability – to deliver on the strategy. Ross, Beath and Mocker (2019) suggest five building blocks (really organisational capabilities) needed for digital success.

- **Shared customer insights** are created by configuring people, processes and technology to learn what customers want. The example worth looking at is Schneider Electric (See Willcocks, 2021b, Chapter 9, pp.230–31, section 9.4).
- **Operational backbone** requires the configuration of people processes and technology to ensure reliable, efficient core processes to support stable operations. Without an excellent operational backbone, Amazon might well not deliver packages on time and to the right addresses; Uber might well not have a reliable customer payment system. CEMEX, discussed in Chapters 5 and 13, is an example of an international business with a strong operational backbone. The LEGO Group's operational backbone has also positioned the company for becoming a digital business. For these examples see Willcocks (2021b) Chapter 9, section 9.4.
- **Digital platform building**: LEGO's operational backbone is an asset, it uses digital technologies (amongst others), but it is not a digital platform, and not enough for digital success. Ross et al. (2019) define a digital platform as 'a repository of business, data, and infrastructure components used to rapidly configure digital offerings'. Willcocks (2021b) Chapter 9, section 9.4 provides the example of

Toyota Motor North America and Serco Pacific Inc., which, in 2018, launched its digital offering Hui, a car share service that initially made available 70 vehicles at 25 easily accessible locations in Honolulu.

- **An accountability framework**: This building block establishes ownership for each digital component through the distribution of responsibilities for digital offerings and components that balances autonomy of teams and alignment with business goals Ross et al, (2019) suggest eight principles for balancing autonomy with alignment (see Willcocks, 2021b, Chapter 9, p.233, section 9.4).
- **An external developer platform** is needed: This comprises a repository of digital components open to external partners. For example, Google makes Google Maps available to other companies for use in their own digitial offerings. On the other hand, Apple invites external app developers to place themselves on the Apple App Store. Willcocks (2021b) Chapter 9, section 9.4, also describes examples of DBS bank, Uber, and Royal Philips. We are in 'complementor' territory here – collaborating in order to compete (see Chapter 8).

Treating digital business design as a set of building blocks has the advantage of allowing managers to focus on specific manageable organisational changes, while implementing holistic design. This is possible because the building blocks are interdependent and mutually supporting. However, they can also be flexibly developed in terms of pace, and also in terms of fit with current and future business strategy. All five building blocks require substantial investments of organisational resources to create capabilities – so this is a resource-based approach as discussed in Chapter 8.

Activity

Read Willcocks (2021) section 9.4, pp.230–34. There are a lot of useful illustrative examples here.

Answer the following:

1. Why and how does Schneider Electric focus its attention on shared customer insight? What business value does the company get from this?
2. Describe how the LEGO Group has built its operational backbone. What business value has it gained from this?
3. Assess how Toyota and Serco have built a digital platform, and the business purposes this has helped achieve.
4. What are the main principles for building an accountability framework for going digital?
5. How have Uber, Royal Philips and DBS bank built an external developer platform, and what do you think they gain from this?

16.5 Digital transformation: why and how

In sections 16.2, 16.3 and 16.4, we have seen the key components of how to become an international digital business. These are: technology, competitive digital positioning, and capability building. This gets us so far, but effective change management is also needed to achieve digital transformation. Before we look at change management, let's consider whether the effort is worthwhile! McKinsey Global Institute (2019) found that failure on digital transformation happens five times more frequently than success. Wade and Shane (2020) uncovered a pre-COVID-19 digital transformation failure rate of 87.5 per cent – much higher than for the other kind of major projects discussed in Chapter 15. They point to four main reasons: unrealistic expectations, limited scope, poor governance, and underestimating cultural barriers. Perhaps it's not even worth starting a digital transformation effort?

Well, the evidence shows that being slow to adopt, or not adopting digital technologies may reduce risk in the short term, but builds growing business risk in the long term (Willcocks, Hindle and Lacity, 2019; McKinsey Global Institute 2018, 2019). Competitively, across sectors, top performers are gaining disproportionately large gains, with correspondingly heavy losses for those falling behind. According to MGI (2018), early automation adopters, as front-runners, will gain 122 per cent in cash flow between 2018–30, while followers will gain only 10 per cent, and laggards will lose 23 per cent.

We are finding that most organisations have been surprisingly slow into digital transformation (Willcocks, Hindle et al., 2019). Slow progress reflects the barriers to change inherited from older business models, strategies, and their supporting processes, technology, data, skills, culture, structures, and managerial mind-sets. Ross, Beath and Nelson (2020) recognise that for an established organisation, existing organisational structures, legacy systems, and embedded habits are significant obstacles. They therefore suggest an evolutionary approach of gradual componentisation of parts of the business, producing digitised business operations and units that fit together over time building towards creating a digital business.

All this suggests that senior executives responsible for digital transformation will need to take a much bigger view of the change process, if the potential business value of digital investments is going to be realised.

16.5.1 Effective major change management

Major projects mean big change, to which the organisation itself needs to adapt. Moving into American or Asian markets, embedding digital transformation, rolling out a new world car – such strategic moves need not just change management underpinning the project, but also require the organisation itself to change, to some degree or other. How to achieve this? Adopting programme management offices and applying big project management disciplines help here, at the project level – see Chapter 15. But to behave strategically, over three years to five years, to change culture, work habits, redesign processes, and apply and evolve technologies as they become available, does require more transformational practices.

The more strategic and transformational the project, the more a comprehensive, systematic approach is needed. Look at Willcocks (2021b) Chapter 8, figure 8.8, p.215, section 8.6. This shows that there are two types of barrier that managers can do little about. One is the setting – the external environment, its complexity and external stakeholders. The other is the psyche of people – their innermost qualities that translate into their fears, desires, what they will resist and defend. The psyche cannot be changed in a short period, if at all. The good news is that all the other likely barriers, including culture and assumptions, are manageable and changeable, provided an integrated, planned approach to change is adopted. The other good news is that the framework can be applied to all large-scale international business projects; here we take the example of digital transformation.

There are six tracks that need to be managed on a mutually informing basis. The sequence is shown in Willcocks (2021b) figure 8.8, p.215. The first three tracks are culture, management skills and team building. These adjust the **behavioural** infrastructure of the organisation. The focus here is on developing an adaptive inner organisation. Without this, changes to the outer organisation – strategy, structure, rewards systems and technologies – will be cosmetic and short-lived. The rough sequencing of the change activities is shown in Willcocks (2021b), figure 8.8. Senior management will need to arrive at a provisional plan for **business strategy, technology ad processes,** but these will be subject to change in the light of what the emergent culture, management skills and teams make possible.

Culture: We looked at culture before in Chapter 3. Shifting the culture, by identifying the shared norms, values, and change propensity organisational members are willing to commit to, must start immediately and continue throughout the change process. What should this culture be? One that stakeholders will buy into. For digital transformation, Westerman, Soule et al. (2019) suggest that the four founding values of digital culture are:

1. **Impact**: changing the world radically through constant innovation.
2. **Speed**: moving fast and iterating rather than waiting to have the answers before acting.
3. **Openness**: engaging broadly with diverse sources of information and insight; sharing advice and information openly rather than keeping knowledge to oneself.
4. **Autonomy**: allowing people high levels of discretion to do what needs to be done rather than relying on formally structured coordination and policies.

Management skills, then team building: On technology, our experience with IT and digital technologies is that these need to be in the 'first order thinking' done at the time of, and included, in the first formulation of business strategy. A feasibility analysis of organisational readiness to accept and deliver the technological changes should be carried out then, and a natural checkpoint for digital transformation comes when trying to establish stakeholder buy-in and governance. Management and teams will need to regularly liaise over technology delivery and driving out business value.

Rewards system: Adjust the rewards available so that they incentivise changed behaviour and target required business outcomes.

Throughout, senior sponsors, project champions, and managers will need to be alive to the organisational politics that breed in times of technological change.

Activity

Read Willcocks 2021b) Chapter 8, pp.213–16, section 8.6 and figure 8.8. Then answer the following:

1. Why is digital transformation so difficult, and why is it so necessary for an international business?
2. What is culture, and why is it so central to any major change process?
3. Make notes on the sequence of the six culture tracks suggested by the Willcocks (2021b) framework (See Willcocks, 2021b, figure 8.8).

16.5.2 A case in point: digital transformation at DBS

Let's now work through a concrete example of how digital transformation can be achieved. The integrating case we are going to look at is DBS bank based in Singapore. It is a very useful case for bringing together the major developments in the use of information, communication and digital technologies, and their importance for international businesses during the third decade of the 21st century. The bank answers the question: how do you rewire an organisation for digital transformation?

Going back to 2010, DBS Bank's senior management had seen rising demand from digitally savvy customers. In fact, Asia had 700 million digital banking users in 2014, expected to grow to over 1.7 billion by 2021. Younger, more mobile-centric customers preferred to engage with banks differently (e.g. through smartphones). Emerging threats from the fintech revolution had to be pre-empted. Going digital also offered a new powerful platform for growth internationally. The CEO Piyush Gupta spelled out the vision:

'If we are able to leverage fintech, and offer banking through digital channels, the need for a large geographic footprint in order to scale up in large geographies such as China, India or Indonesia becomes less of an imperative. A successful digital banking strategy will enable us to accelerate our access to emerging markets without the need for a large and expensive bricks and mortar network.'

By 2021 DBS Bank Singapore had become globally recognised as an exemplar of how to achieve digital transformation. DBS Bank (DBS) had grown from a Singapore-based bank to become the largest bank (by assets) in Southeast Asia. It provides a full range of financial services for institutional banking, consumer banking and wealth management, and has over 280 branches in 17 countries, mainly in South East Asia, South Asia and Greater China. How was this achieved, and what are the learning points?

Activity

Read the DBS bank case in Willcocks (2021b) Chapter 9, pp.235–40, section 9.6. Answer the following:

1. What is GANDALF strategy, and why do you think DBS bank adopted it?
2. Looking at the overall approach to change, what were the four building blocks, and how were structure, technology, process and people addressed in each of the building blocks?
3. How important to DBS bank was improving the customer experience? Give examples of how this was achieved.
4. What agile, scaleable, digital operations did the bank build, with what business results?
5. Give examples of the digital innovations DBS bank has been able to roll out as a result of having become a digital business.

16.6 Key concepts

The key concepts in this chapter are:

- digital transformation: what, why, how
- foundational and emerging technologies (SMAC/BRAIDA)
- digital business model – content, experience, platform

- digital business building blocks
- major organisational change management.

16.7 Reminder of your learning outcomes

Having completed this chapter, and the Essential reading and activities, you should be able to:

- define digitisation, digitalisation and digital transformation
- assess the major challenges and critical success factors when building a digital business
- describe and assess 10 major digital technologies used in building digital business
- explain the components of a digital business model, and apply these to assessing actual international businesses
- identify the building blocks of digital business, and analyse an international business's digital transformation progress
- participate in discussions on digital transformation: why, how; and support arguments with international business examples of failure and success.

16.8 Test your knowledge and understanding

For revision purposes have a look at this video by Jeanne Ross of MIT speaking about her research into digital transformation:

- www.youtube.com/watch?v=lAcntfkISiM

Now answer the following questions:

a. Dr Ross talks of SMACIT technologies. Make notes on these and compare with the SMAC/BRAIDA listing in section 9.2 above. What is she missing?

b. Note (after 10 minutes of the video) the three examples she gives to illustrate moves towards digitalisation – Amazon, Schneider, and Philips, all mentioned above.

c. Dr Ross then distinguishes between digitised and digital (digitalised). Describe what she means by these terms.

16.9 Sample examination question

'Digital transformation is both very challenging and very necessary for international businesses in the 2021–2025 period.' Answer the following:

a. What is digital transformation and how is it different from digitisation and digitalisation?

b. Why is digital transformation so difficult? Why is it so necessary?

c. Using illustrative examples, describe a resource-based approach to the building blocks for digital business success.

Notes