POLITECNICO
DI MILANO

# Strategy & Marketing

## *Internationalisation Strategy*

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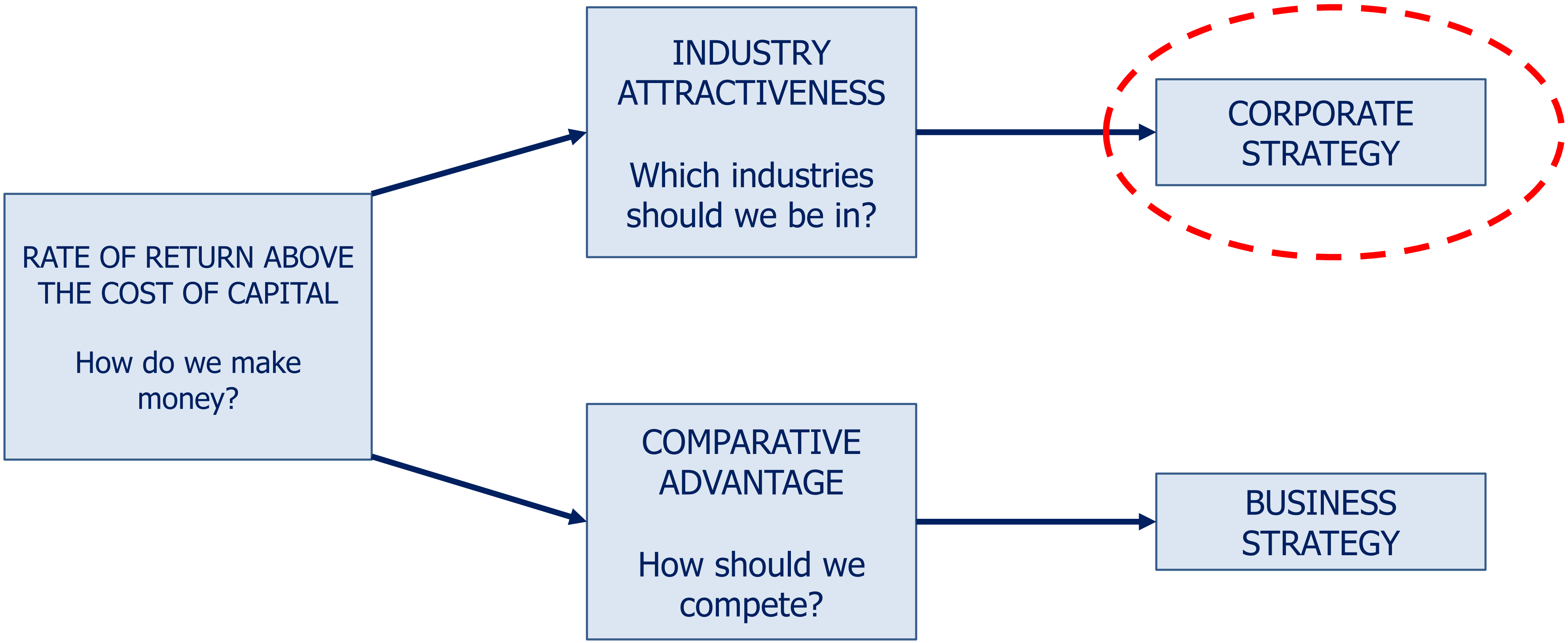
# Levels of Strategy




**Source: Grant (2010)**

# Corporate Strategy



- Corporate Strategy has to deal with the following **scopes:**
  - **Product scope**: how specialised should the company be in terms of the range of product it supplies? (e.g. Coca-Cola is specialised while GE is diversified)
  - **Geographical scope**: what is the optimal geographical spread of activities for the company

# Introduction

- Since the 60's, one of the most changing forces which has affected the business environment and the competition has been the **trend towards internationalization**, with two main outcomes:
    - Growth in the world trade
    - Growth in foreign investments by large companies (MNEs - multinational companies)

# Foreign investments

FDI inflows: the value of inward direct investment made by non-resident investors in the reporting economy.

| Item | Value at current prices (Billions of dollars) | | | | |
|---|---|---|---|---|---|
| | 1990 | 2005–2007 (pre-crisis average) | 2013 | 2014 | 2015 |
| FDI inflows | 207 | 1 418 | 1 427 | 1 277 | 1 762 |
| FDI outflows | 242 | 1 445 | 1 311 | 1 318 | 1 474 |

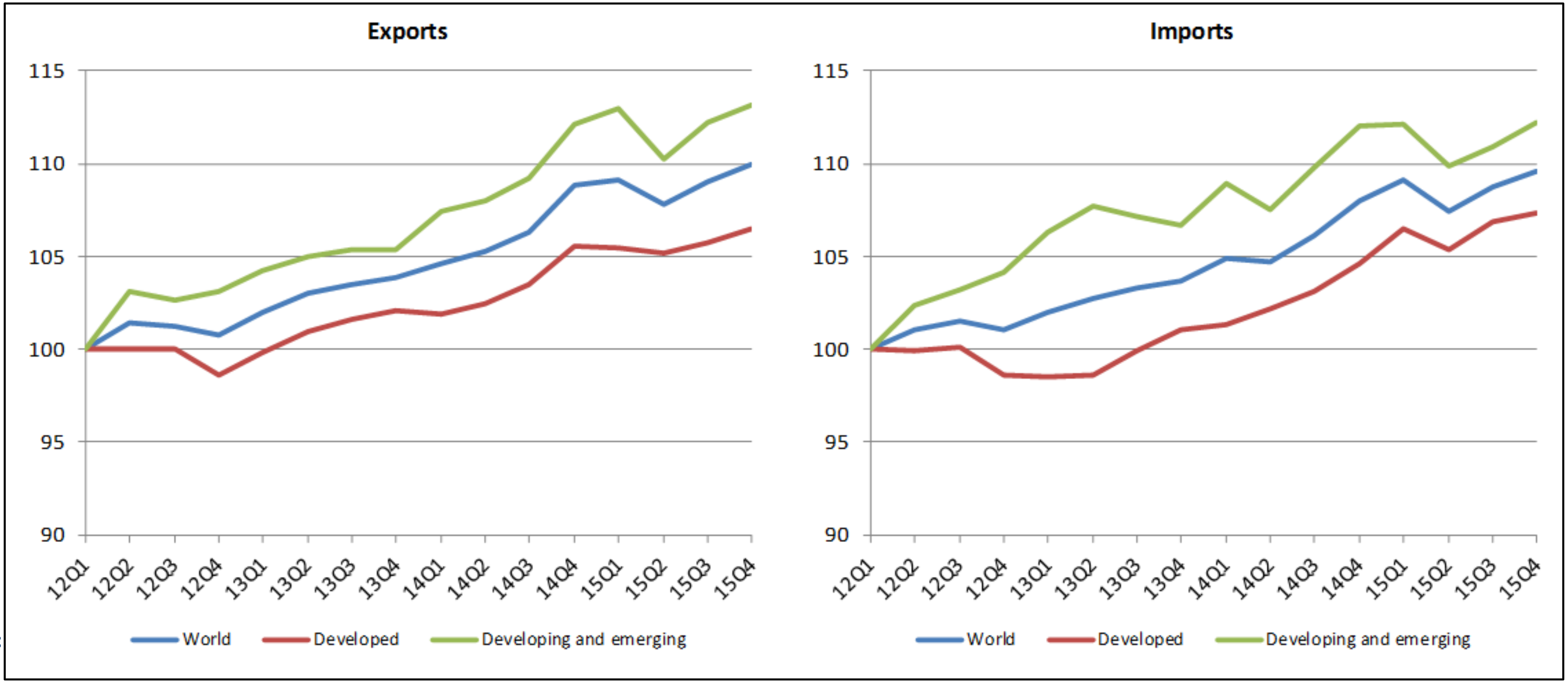
FDI outflows: the value of outward direct investment made by the residents of the reporting economy to external economies.

Source: UNCTAD, *World investment report 2016*

# International trade

In the last 20 years (1995–2015), the average annual growth rate in world merchandise trade was equal to 5.3%.

Volume of world merchandise exports and imports (1990=100)




Source: WTO Secretariat

# Patterns of industry internationalisation

| International Trade | Low Foreign Direct investment | High Foreign Direct investment |
|---|---|---|
| High | **Trading Industries**<br>• Aerospace<br>• Military hardware<br>• Diamond mining<br>• Agriculture | **Global Industries**<br>• Automobiles<br>• Oil<br>• Semiconductors<br>• Consumer elet |
| Low | **Sheltered Industries**<br>• Railroads<br>• Laundries/dry cleaning<br>• Hairdressing<br>• Milk | **Multidomestic Industries**<br>• Packaged groceries<br>• Investment banking<br>• Hotels<br>• Consulting |

Source: Grant (2010)

# Implications for competition

Internationalisation usually means more competition and lower industry profitability:

- **Entry barriers have substantially fallen** (tariff reduction, cost of transportation, removal of exchange controls, internationalisation of standards, convergence of customer preferences)

- **Rivalry among existing firms increases** as internationalisation lowers seller concentration, increases competitor diversity, and increases excess capacity

- **Bargaining power of buyers increases** as large customers can exercise their buying power far more.

# Why - Determinants of international expansion

- The determinants of firms international expansion refer to:
  - **Expansion of the business**
    - Internal markets are saturated
    - Internal markets are too small

  - **Access to resources and production input**

    Examples:
    - Tyres manufacturers that have directly managed rubber plants
    - Oil companies that have expanded to Canada and Venezuela in order to exploit oil wells;
    - Aluminum producers who have accessed bauxite deposits through international expansion

# Determinants of international expansion



- **Business portfolio balancing (balancing risk)**
  - Create medium-long term stability and growth, given that the same product can be at different stages of its lifecycle in different countries
  - Balance risks related to economic/technological/socio-political cycles in different countries

- **Search for efficiency**
  - *Economies of scale*: extending its market beyond national boundaries, a firm is able to increase the production scale and reduce the average unit production cost.
  - *Economies of scope*, i.e. efficiency benefits arising from the sharing of some resources in multiple markets (typically transportation and distribution network)
  - *Efficiency in resources purchasing*

# Determinants of international expansion



- **Market expansion**
  - Homogeneity and globalization of customers' preferences
  - Global presence of customers
  - Global presence of distribution channels
  - Transferability of marketing campaigns

- **Competence development**
  - Access to critical technological skills for innovating and sustaining its competitive advantage.

  Example: firms in the Silicon Valley in order to exploit the expertise on semiconductors

# Determinants of international expansion



- **Benefits of positioning**:
  - Accepting lower levels of profitability in certain geographic areas, against higher profitability in other countries.

  Example: Samsung has been able to enter into the US market (which is strategically important for the company image and access to external expertise), although with low profits, thanks to the highest profitability obtained in Asia and South America

# Disadvantages of international expansion

The liability of foreignness: additional costs of doing business in an unfamiliar environment and of coordinating across geographic distances

Loss of reputation

Loss of intellectual property

# Strategic decisions in international business



- There are **two key variables** in the definition of a internationalization strategy:
  - **The selection of the geographical location (where)**
  - The modes of international expansion (how)

# The determinants of geographical location



- Decisions related to the geographical location should take into account **three main factors**:
    - Influence of national resources
    - Specificity of the competitive advantage
    - Assets transferability

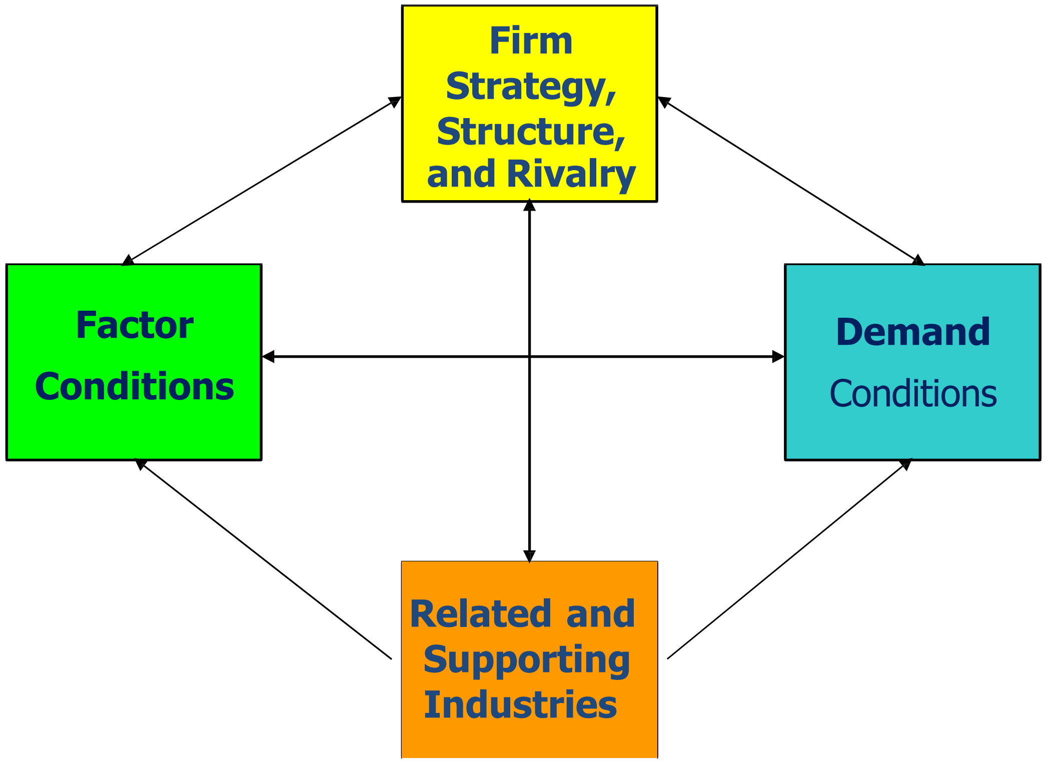
# The influence of national resources

- When the resources of a nation exert a dominant influence on a firm's competitive advantage, **it should locate itself where such conditions are more favorable**

- Examples:
  - For Nike and Reebok the labour cost is of paramount importance. Therefore they located their manufacturing plants in low labour cost countries: China, Thailand, India, Philippines
  - Most PC manufacturers or telco equipment manufacturers have established R&D units in the US (especially within the Silicon Valley) in order to leverage existing skills in the field of microprocessors

# The Porter's Diamond of National Advantage

- Porter's national diamond framework identifies four key factors that determine **a country's advantage** within a particular sector.



# The Porter's Diamond of National Advantage



- **Factor Conditions**: the nations's positions in factors of production, such as skilled labor or infrastructure, necessary to compete in a given industry.
- **Demand Conditions**: the nature of home-market demand for the industry's product or service.
- **Related and Supporting Industries**: the presence or absence in the nation of supplier industries and other related industries that are internationally competitive.
- **Firm Strategy, Structure and Rivalry**: the conditions in the nation governing how companies are created, organised and managed, as well as the nature of domestic rivalry.

# Specificity of the competitive advantage



- **The advantage of location**, for firms whose competitive advantages stem from internal resources and skills, **depends on where they can make the most of such skills**

- Example:
  - the competitive advantage of Toyota, Nissan and Honda is based on their expertise in product design, development and manufacturing. During the 80s they showed that they could make the most of it in the US

# Assets transferability

- The possibility to localize products manufacturing away from the target markets depends on their transferability. **High transportation costs or pronounced national preferences of consumers can push towards local production**.

- It is also possible that the local authorities impose barriers to imports in order to force global companies to build factories on site.

# The location decisions and the value chain



- The location decisions should take into account the fact that **the supply of any product or service is made up of a chain of activities** which differ significantly

- As a result, it is possible that each activity in the chain has its ideal location in a different country

- Example:
    - In the consumer electronics industry, the components manufacturing (which is characterized by strong investment in research and fixed assets and significant economies of scale) is concentrated in industrialized countries (e.g. USA, Japan), while the assembly phase (which is characterized by a high intensity of labour) is located in developing countries or newly industrialized countries (e.g. Asia and Latin America)

# Example: Nike

- Nike is an example of company that exploits the benefits of location of the activities of its value chain in different countries:
    - Design and R&D: US
    - Production of textiles, rubber and plastic components for footwear: Korea, Taiwan and China
    - Assembly: India, China, Philippines, Thailand and other countries with low labor costs
    - Marketing and distribution: US, Europe and other industrialized countries

# Strategic decisions in international business

- There are **two key variables** in the definition of an internationalization strategy:

  - The selection of the geographical location (where)

  - **The modes of international expansion (how)**

# Modes of international expansion

- There are many **strategic alternatives under which a company can entry into a foreign market**:
    - **Export** (spot contracts, long-term contracts, use of agents and foreign distributors)
    - **Trademarks and technology licensing**
    - **Direct investment**:
        - **External growth**:
            - shareholding
            - joint ventures
            - acquisitions
        - **Internal growth** (owned subsidiary):
            - With only sales and marketing functions
            - Fully integrated (i.e. including production)

# The main advantages of external growth



- The main **advantages** of the external growth compared to the internal growth are:
    - Rapid achievement of distribution and service networks
    - Acquisition of established brands
    - Availability of a suppliers and sub-suppliers network
    - Learning of different organizational and management cultures
    - Facilitation in the relationships with local governments

# The main disadvantages of external growth

- On the other hand, the external growth has the following **disadvantages**:

  - Competition with existing brands and channels

  - Difficulty of matching among different cultures

  - Homogenization of production and management systems

# Strategic-organizational models selection



- An internationalised company has to choose the appropriate organisational model
- The choice of the strategic-organizational model comes from the prevalence of one of the two opposing forces:
  - Determinants of **integration,** i.e. forces pushing for cost reduction through the adoption of a global standardisation strategy
  - Determinants of **local responsiveness,** i.e. forces pushing for tailoring product and service offerings to fit local customers and host-country requirements

# Determinants of integration

- Presence of key international customers
- Presence of international competitors
- Investment intensity
- Technological intensity
- Needs/opportunities regarding cost reduction
- Markets homogeneity
- Concentration of raw materials sources

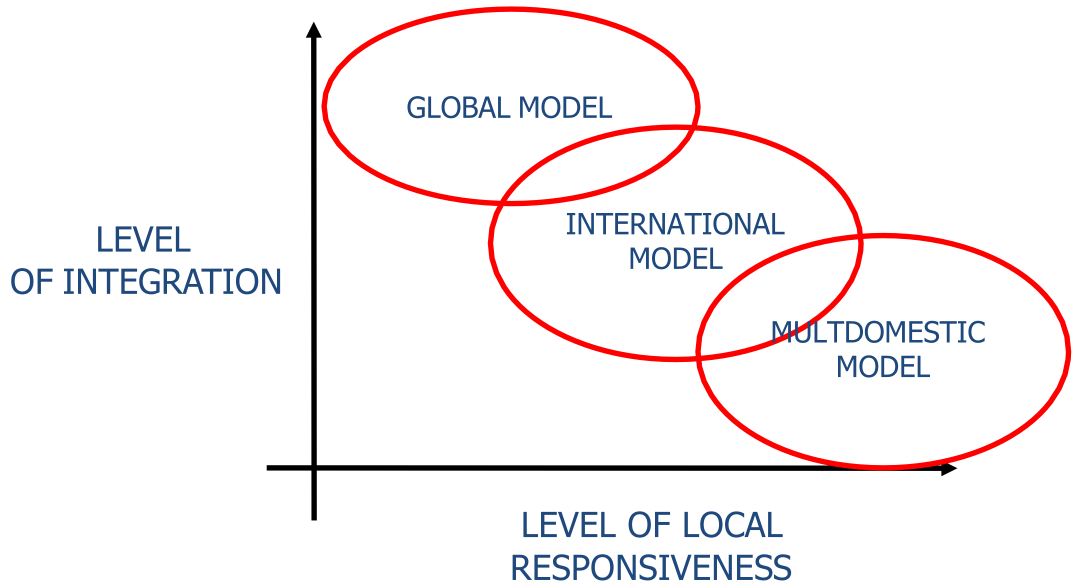
# Determinants of local responsiveness

- Differences about consumer needs
- Differences about distribution channels
- Presence of substitute local products
- Market fragmentation
- Needs of local governments

# Strategic-organizational models of a global firm

- The traditional **strategic-organizational models of a firm that operates on a global scale**, to which different configurations in terms of the location of production facilities and assets and overall strategic guidance are related, are:

  - international model
  - global model
  - multidomestic model



# International model

- It aims to **centrally develop new products/processes which are then exploited on a global scale**. The internationalization process consists in the transfer of products to other countries where they may be adapted to local needs

- It requires the **centralization of the critical resources for the conception, development and production of products at the headquarters** and the development in foreign countries of those resources that are necessary to adapt the new products and services to local needs

# International model

Often the first step in internationalisation

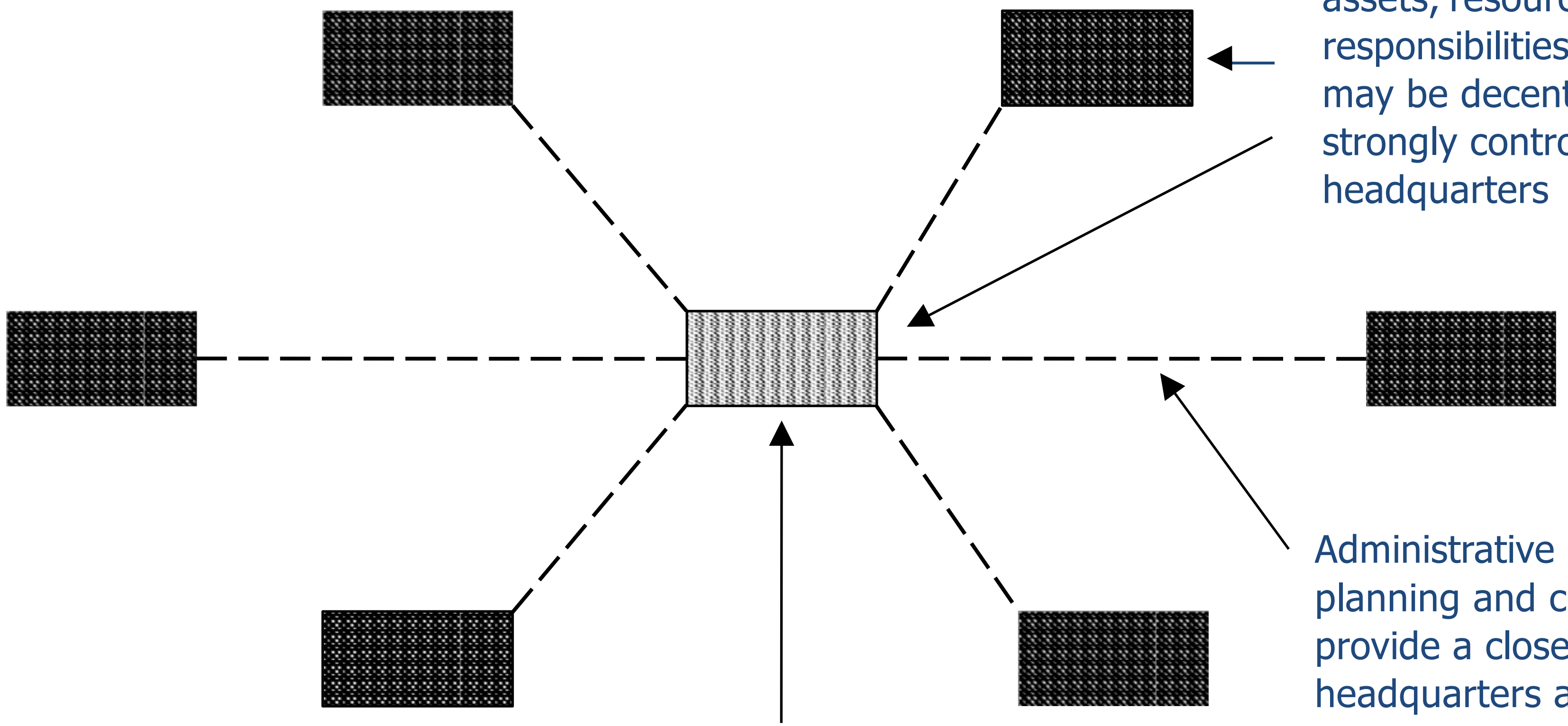
•Used by MNEs with relatively large domestic markets or strong exporters (e.g., MNEs from the U.S., Germany, Japan, South Korea)

•Well-suited for high-end products with high value-to-weight ratios such as machine tools and luxury goods that can be shipped across
the globe.

• Products and services tend to have strong brands.

•Main business-level strategy tends to be differentiation because exporting, licensing, and franchising add additional costs.

# International model



Coordinated federation: assets, resources, responsibilities and decisions may be decentralized, but strongly controlled by the headquarters

Administrative control: formal planning and control systems provide a closer link between headquarters and subsidiaries

International mentality
the management considers the geographically distributed activities as appendages of a centralized enterprise

# International model

- Main advantage:
  - Ability to take advantage of the wealth of knowledge, expertise and reputation of the parent company on a global scale
  - Low cost of implementation (export, licensing)

- Main disadvantage:
  - Poor flexibility and efficiency compared to the multinational and global models
  - No or very limited local responsiveness
  - Risk of expropriation of IP

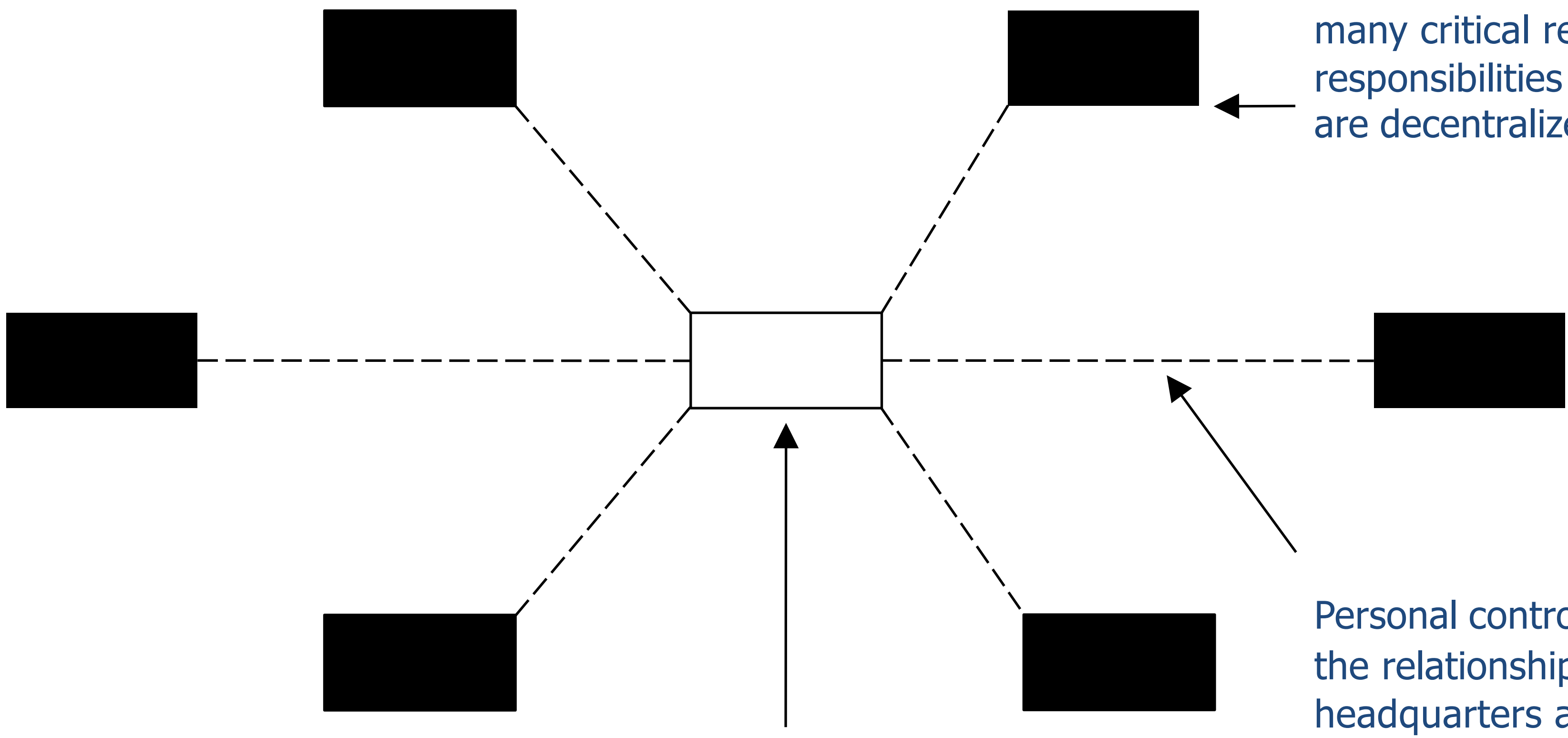
- Examples: Harley Davidson, Starbucks, Rolex

# Multidomestic model

- It leverages on the existing differences among different countries, trying to **differentiate their products/processes in line with local customers needs** and with economic and institutional factors

- This implies the localisation of the firm's business units in different countries (**geographically dispersed and resources**), which manage the business locally, **develop innovations locally** and perform activities (from production to sales) with **relative autonomy**

# Multidomestic model



Decentralized federation:
many critical resources, responsibilities and decisions are decentralized

Multinational mentality:
the management considers the geographically distributed activities as a portfolio of independent businesses

Personal control:
the relationships between headquarters and subsidiaries are of an informal nature and the control is simple and mainly related to financial aspects.

# Multinational model

- Main advantage:
  - High flexibility and strong ability to effectively respond to local needs with a strong increase of differentiation
  - Perception of the company as a local company

- Main disadvantage:
  - Low efficiency and difficulty in exploiting on a global scale knowledge and expertise held by the parent company and the local subsidiaries (no learning across subsidiaries)
  - Risk of duplication of resources and activities
  - Risk of expropriation of IP

- Examples: Nestle, Philips, Unilever; in general used in the food and consumer goods industries

# Multidomestic model and leverage of local resources

UNILEVER:

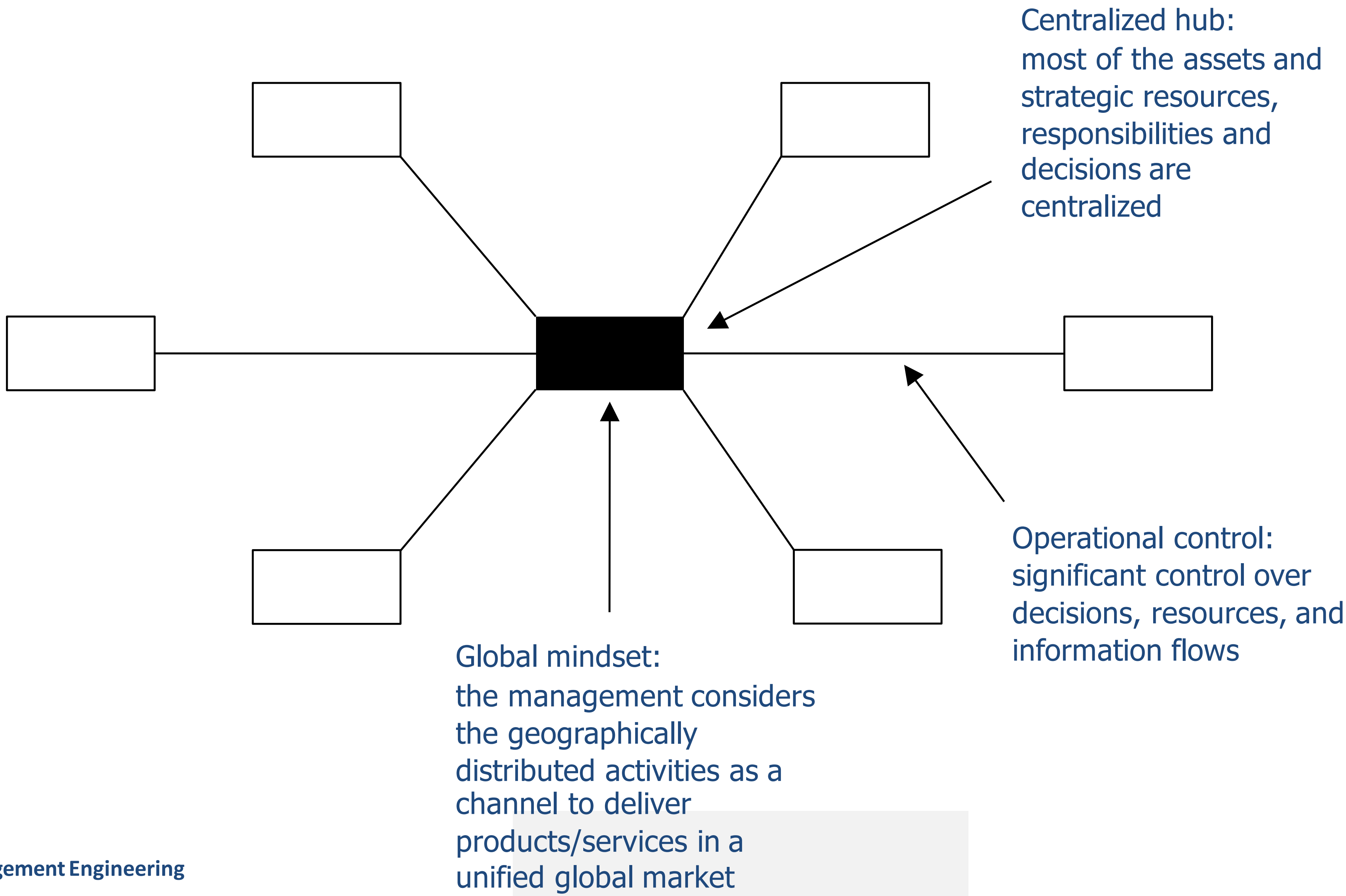
- The R&D unit located at the German subsidiary develops a new fabric softener (Kuschelweich) which achieve a significant market share in Germany in a short time, thanks to its technical features and shrewd marketing strategy
- The top management at the company headquarters recognizes that the key to success is represented by the symbol associated with the product (‘a bear')
- The brand developed in Germany and the adopted marketing strategy are transferred to other markets worldwide: CAJOLINE in France, COCCOLINO in Italy, MIMOSIN in Spain and HUGGY in Australia

# Global model

- It tries to **maximize efficiency on a global scale** by exploiting the economies of scale and neglecting the differences among the various countries in which the firm operates

- This implies a **significant resources and activities concentration** (from production to R&D) in a single country (where best-in-class capabilities reside at lowest costs). Geographically dispersed units have a role only regarding sales and customer support activities

# Global model



# Global model

- Main advantage:
  - High efficiency obtained by the exploitation of economies of scale
  - Location economies: global division of labor based on wherever best-of-class capabilities reside (often searching for lowest cost).
  - Economies of standardization.

- Main disadvantage:
  - Limited flexibility (no differentiation), risks related to the protectionist policies by the countries that import the firm's products and risk related to the exchange rates fluctuations.

- Examples:
  - Lenovo, Siemens Energy, Boeing, Rolls-Royce

# The transnational model

During the 90s, companies operating on a global scale attempted to reconcile the economies of scale (typical of global structures) and the benefits of national differentiation

This gave rise to a transnational model, which is based on **an integrated network of resources and widespread but interdependent competences**

It is based on the assumption that an internationalization strategy should **simultaneously attempt to minimize costs and maximize revenues**, i.e. leveraging on efficiency, innovation and differentiation

Therefore this approach tries to take advantage of all other types of models, which requires **a suitable and very complex assets and capabilities configuration**

# The transnational model

In a transnational company:

- The key resources are centralized at the company headquarters in order to exploit economies of scale and to protect the distinctive competencies *(e.g. the design capability)*

- Other resources can be centralized, even not at the company headquarters – the so-called “excentralisation” *(e.g. labor intensive processes that are concentrated in areas with low labor costs or R&D activities that are concentrated close to centers of excellence in a specific discipline)*

- Finally, other resources can be decentralized to different countries, if economies of scale are not relevant and there is an opportunity of local differentiation, a need for flexibility or for risk reduction *(e.g. delocalized production plants reduce the risks associated with exchange rates or strikes)*

# The transnational model

A very complex configuration of assets, resources and competences emerges, in which:

- **Each local unit is independent**, but it is a source of ideas and competences for the whole company

- **Local units can reach a global scale**, focusing on specific products, components or activities in favor of the whole company

- The headquarter manages the global network **by defining the role** of each local unit and **developing a common culture** and **effective communication systems**

# How to create a transnational organization

The transnational model is a **development direction** rather than a specific organizational form. It represents a synthesis of different multinational strategic configurations

Companies that adopted traditional configurations have **gradually** moved to a transnational model, following different patterns.

# Outline

| | MULTINATIONAL | INTERNATIONAL | GLOBAL | TRANSNATIONAL |
|---|---|---|---|---|
| **STRATEGIC ORIENTATION** | Building flexibility in order to respond to national differences through the creation of autonomous, entrepreneurial local with own resources | Exploiting the company headquarters' knowledge and capabilities through the dissemination and adaptation of new products/services at global level | Building cost advantages through centralization and economies of scale | Developing efficiency, flexibility and learning at global level simultaneously |
| **CONFIGURATION OF ASSET AND CAPABILITIES** | Decentralized and self-sufficient at national level | Centralized distinctive competencies, others are decentralized | Centralized on a global scale | Scattered, independent, and specialized |

# Examples of transnational models

FORD: The development of the Mondeo is the result of a project organized following such approach:

- During the PRODUCT DESIGN phase groups operating in different locations were involved :
  - Dearborn (US) for V6 engines and transmissions
  - Merkenich (Germania) for aesthetics and L4 engines
  - Dunton (UK) for the interiors

- During the PROTOTYPING phase groups operating in different locations were involved:
  - Bridgend (Galles) for L4 1.6 and 1.8 liters engines
  - Dagenham (UK) for diesel engines
  - Cleveland (Ohio) for V6 engines
  - Chihuahua (Messico) for L4 2,0 liters engines

# Examples of transnational models

NISSAN: The development of a minivan results from a transnational project that involved:

The Technology Centre at the company headquarters (engines and transmission systems)

3 technical centres in the US:

- Nissan Design International in California (styling)
- Nissan Research and Development in Michigan (stamping)
- Nissan Motor Manufacturing Centre in Tennessee (engineering)

IBM: The development of the ThinkPad Notebook Computer results from a transnational project which involved:

IBM Design Centre in Yamato (Japan)

IBM's Almaden Research centre in San Josè (California)

IBM Corporate Design unit in Stamford (Connecticut)

Industrial designers in Milano

# (Dynamic) differentiation of local units roles and responsibilities

A critical aspect in the strategy globalization is **the allocation of roles and responsibilities to geographically dispersed units**

LEVEL OF LOCAL RESOURCES AND CAPABILITIES

STRATEGIC IMPORTANCE OF LOCAL ENVIRONMENT

| | LOW | HIGH |
|---|---|---|
| HIGH | BLACK HOLE | STRATEGIC LEADER |
| LOW | IMPLEMENTER | CONTRIBUTOR |