CHAPTER 10 Global Strategy: Competing Around the World

Chapter Outline

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Learning Objectives

LO 10-1 Define globalization, multinational enterprise (MNE), foreign direct investment (FDI), and global strategy.

LO 10-2 Explain why companies compete abroad, and evaluate the advantages and disadvantages of going global.

LO 10-3 Apply the CAGE distance framework to guide MNE decisions on which countries to enter.

LO 10-4 Compare and contrast the different options MNEs have to enter foreign markets.

LO 10-5 Apply the integration-responsiveness framework to evaluate the four different strategies MNEs can pursue when competing globally.

LO 10-6 Apply Porter's diamond framework to explain why certain industries are more competitive in specific nations than in others.

Sweden's IKEA: The World's Most Profitable Retailer

THE WORLD'S MOST profitable global retailer is not Walmart or the UK-based Tesco, but IKEA—a privately owned home-furnishings company hailing from Sweden. In 2017, IKEA owned more than 400 stores in various formats worldwide in 28 countries, employed over 160,000 people, and earned revenues of more than 35 billion euros. Exhibit 10.1 shows IKEA's growth in the number of stores and revenues worldwide.

Known today for its iconic blue-and-yellow big-box retail stores, focusing on flat-pack furniture boxes combined with a large do-it-yourself component, IKEA started as a small retail outlet in 1943 by then-17-year-old Ingvar Kamprad. Though IKEA has become a global phenomenon, it was initially slow to internationalize. It took 20 years before the company expanded beyond Sweden to its neighbor Norway. After honing and refining its core competencies—designing and offering modern, and functional home furnishings in a unique retail experience resulting in a low cost structure—in its home market, IKEA followed an international strategy, expanding first to Europe and then beyond. Under this strategy, IKEA can

Sweden's IKEA is growing quickly in both developed countries, such as the United States and Australia, and also in emerging economies such as China.
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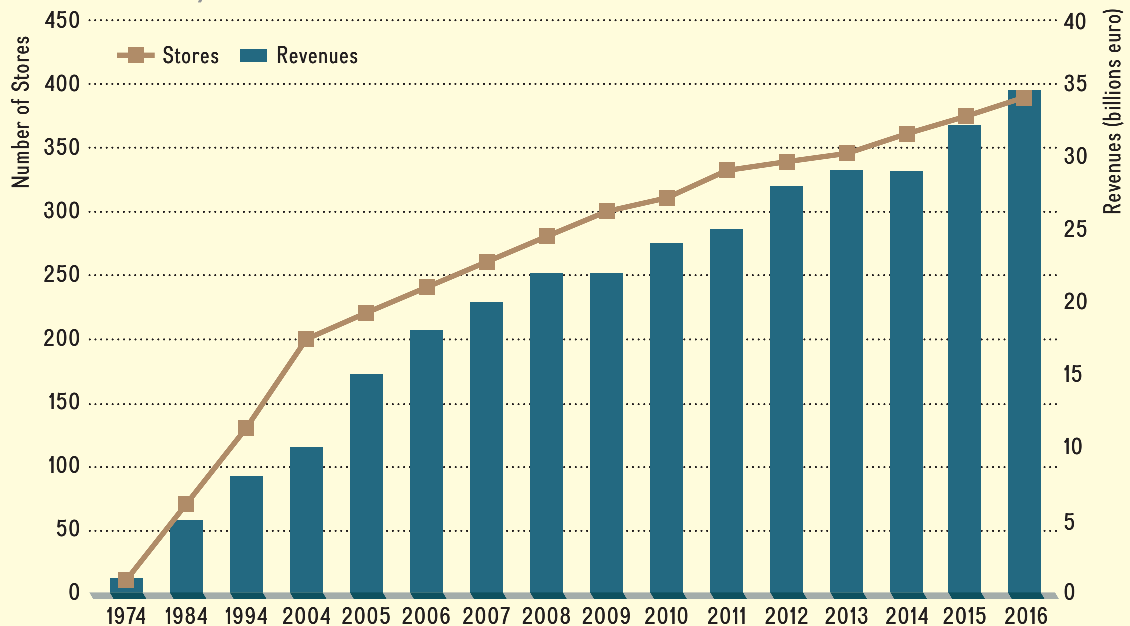
EXHIBIT 10.1 IKEA Stores and Revenues, 1974–2016



SOURCE: Depiction of data from IKEA Yearly Summaries (www.ikea.com), various years.

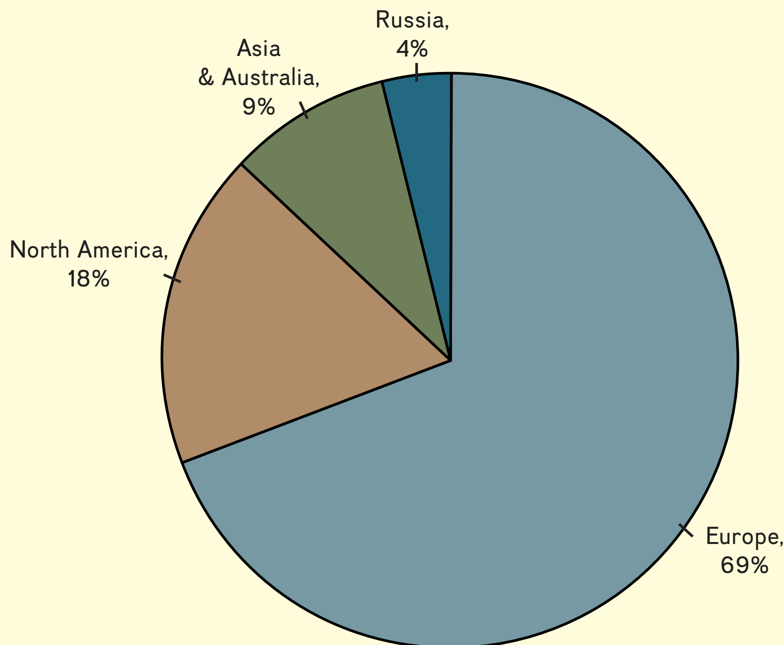
sell the same types of home furnishings across the globe with little adaptation, although it does make some allowances for country preferences. IKEA is present across all major markets today, having entered India and Serbia in 2017.

In recent years IKEA's strategy has evolved. To keep costs low, it shifted from an international strategy to a global-standardization strategy, in which it attempts to achieve economies of scale through effectively managing a global supply chain. Although Asia accounts currently for only 9 percent of its sales, IKEA sources 35 percent of its inputs from this region. To pare costs further, IKEA has begun to implement production techniques from auto and electronics industries, using cutting-edge technologies to address complexity while achieving flexibility and low cost. IKEA's revenues by geographic region are mainly from Europe (69 percent), with the rest from North America (18 percent), Asia and Australia (9 percent), and Russia (4 percent); see Exhibit 10.2. Although IKEA's largest market is in Germany (14 percent of total sales), it is seeing strong growth in China, Canada, Poland, and Australia.

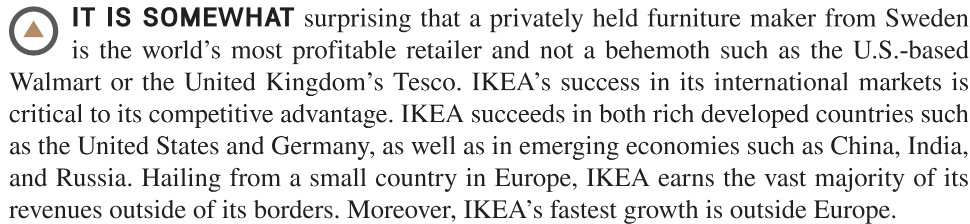
The privately held company has also successfully reinvented itself with changing consumer demands: newer formats such as smaller stores in city centers, click-and-collect locations (small stores for retrieval of online purchases), and more customized furniture solutions to meet the needs of an increasingly urban population. In addition, IKEA is investing heavily in its online presence, enabling consumers to do all their purchasing online, and then schedule delivery, and even installation of furniture. Busy urban professionals are less inclined to spend the well-known frustrating and long hours putting IKEA furniture together ("easy assembly") with the included low-quality tool and minimal instructions. IKEA's functional website (ikea.com) now garners more than 2 billion hits a year. In the meantime, IKEA's big-box stores remain attractive destinations, with over 1 billion visits a year, up from some 750 million just a few years earlier.[1]

You will learn more about IKEA by reading this chapter; related questions appear in "ChapterCase 10 / Consider This...."

EXHIBIT 10.2 / IKEA Sales by Geographic Region (2016)



SOURCE: Depiction of data from IKEA Yearly Summaries (www.ikea.com)



IT IS SOMEWHAT surprising that a privately held furniture maker from Sweden is the world's most profitable retailer and not a behemoth such as the U.S.-based Walmart or the United Kingdom's Tesco. IKEA's success in its international markets is critical to its competitive advantage. IKEA succeeds in both rich developed countries such as the United States and Germany, as well as in emerging economies such as China, India, and Russia. Hailing from a small country in Europe, IKEA earns the vast majority of its revenues outside of its borders. Moreover, IKEA's fastest growth is outside Europe.

IKEA intends to reach sales of 50 billion euros by 2020, up from 35 billion euros in 2016, and double its 2011 sales of 25 billion euros. It wants to own 500 profitable stores globally by 2020, up from some 240 stores in 2006. To accomplish these lofty goals, IKEA must get its global strategy right, especially in growing markets such as China and India. Both are countries with more than 1 billion people each and a rapidly expanding middle class, on which IKEA wants to capitalize.

For more and more U.S. companies, international markets offer the biggest growth opportunities, just as they do for IKEA. Firms from a wide variety of industries—such as Apple, Caterpillar, GE, Intel, and IBM—are global enterprises. They have a global work force and manage global supply chains, and they obtain the majority of their revenues from outside their home market. Once-unassailable U.S. firms now encounter formidable foreign competitors such as Brazil's Embraer (aerospace); China's Alibaba (ecommerce), Haier (home appliances), Lenovo (PCs), and Huawei (cell phones); India's ArcelorMittal (steel), Infosys (IT services), and Reliance Group (conglomerate); Germany's Siemens (engineering conglomerate), Daimler, BMW, and VW (vehicles); Japan's Toyota, Honda, and Nissan (vehicles); Mexico's Cemex (cement); Russia's Gazprom (energy); South Korea's LG and Samsung (both in electronics and appliances); and Sweden's IKEA (home furnishings), to name just a few. This chapter is about how firms gain and sustain competitive advantage when competing around the world.

The competitive playing field is becoming increasingly global, as the ChapterCase about the home-furnishings industry indicates. This globalization provides significant opportunities for individuals, companies, and countries. Indeed, you can probably see the increase in globalization on your own campus. The number of students enrolled at universities outside their native countries quadrupled between 1980 and 2014 to over 4 million.[2] By 2025, the total number is predicted to double yet again, to 8 million.[3] The country of choice for foreign students remains the United States, with more than 1 million international students enrolled per year, followed by the United Kingdom. The top five countries sending the most students to study abroad are (in rank order): China, India, Korea, Germany, and Saudi Arabia.[4]

In Chapter 8, we looked at the first two dimensions of corporate strategy: managing the degree of vertical integration, and deciding which products and services to offer (the degree of diversification). Now we turn to the third dimension: competing effectively around the world. The world's marketplace—made up of some 200 countries—is a staggering $76 trillion in gross domestic product (GDP), of which the U.S. market is roughly $18 trillion, or about 24 percent.[5]

We begin this chapter by defining globalization and presenting stages of globalization. We then tackle a number of questions that a firm must answer: Why should a company go global? Where and how should it compete? We present the CAGE[6] distance model to answer the question of where the firm should compete globally and the integration-responsiveness framework to link a firm's options of how to compete globally with the different business strategies introduced in Chapter 6 (cost leadership, differentiation, and blue ocean). We then debate the question of why world leadership in specific industries is often concentrated in certain geographic areas. We conclude with the practical *Implications for Strategic Leaders.*

LO 10-1

Define globalization, multinational enterprise (MNE), foreign direct investment (FDI), and global strategy.

10.1 What Is Globalization?

Globalization is a process of closer integration and exchange between different countries and peoples worldwide, made possible by falling trade and investment barriers, advances in telecommunications, and reductions in transportation costs.[7] Combined, these factors reduce the costs of doing business around the world, opening the doors to a much larger market than any one home country. Globalization also allows companies to source supplies at lower costs, to learn new competencies, and to further differentiate products. Consequently, the world's market economies are becoming more integrated and interdependent.

Globalization The process of closer integration and exchange between different countries and peoples worldwide, made possible by falling trade and investment barriers, advances in telecommunications, and reductions in transportation costs.

Globalization has led to significant increases in living standards in many economies around the world. Germany and Japan, countries that were basically destroyed after World War II, turned into industrial powerhouses, fueled by export-led growth. The Asian Tigers—Hong Kong, Singapore, South Korea, and Taiwan—turned themselves from underdeveloped countries into advanced economies, enjoying some of the world's highest standards of living. China and India continue to offer significant business opportunities.[8] Indeed, China, with $11 trillion in GDP, has become the second-largest economy worldwide after the United States (with $18 trillion in GDP) and ahead of Japan in third place ($5 trillion GDP), in absolute terms.[9] Adjusting GDP for size of population (per capita) and adjusting for difference in cost of living (purchasing power parity), the United States is in 12th place, China comes in at 92nd, and Japan ranks 27th. The three richest countries in the world by income per person are Qatar, Macao (which is a Special Administrative Region of China), and Kuwait; all of which are smaller but wealthy countries.

multinational enterprise (MNE) A company that deploys resources and capabilities in the procurement, production, and distribution of goods and services in at least two countries.

The engine behind globalization is the **multinational enterprise (MNE)**—a company that deploys resources and capabilities in the procurement, production, and distribution of goods and services in at least two countries. MNEs need an effective **global strategy** that enables them to gain and sustain a competitive advantage when competing against other foreign and domestic companies around the world.[10] By making investments in value chain activities abroad, MNEs engage in **foreign direct investment (FDI)**.[11]

global strategy Part of a firm's corporate strategy to gain and sustain a competitive advantage when competing against other foreign and domestic companies around the world.

foreign direct investment (FDI) A firm's investments in value chain activities abroad.

For example, the European aircraft maker Airbus invested $600 million in Mobile, Alabama, to build jetliners.[12] The new Mobile Aeroplex is a 53-acre facility where Airbus builds the vast majority of its single-aisle A-320 jetliners. Airbus made a significant strategic commitment to the U.S. market, the destination of the majority of its new jetliners; the A-320 is mainly used in domestic U.S. air travel. Being located in Alabama allows Airbus to be much closer to its customers and thus to receive and incorporate feedback, as individual airlines request specific customizations. It allows Airbus to take advantage of business-friendly conditions such as lower taxes, labor cost, and cost of living, plus other incentives provided by host states in the Southern United States. Making Airbus planes in the United States also prevents the European company from being forced to accept import restrictions.

U.S. MNEs have a disproportionately positive impact on the U.S. economy.[13] Well-known U.S. multinational enterprises include Boeing, Caterpillar, Coca-Cola, GE, John Deere, Exxon Mobil, IBM, P&G, and Walmart. U.S. MNEs make up less than 1 percent of the number of total U.S. companies, but they:

- Account for 11 percent of private-sector employment growth since 1990.
- Employ 19 percent of the work force.
- Pay 25 percent of the wages.
- Provide for 31 percent of the U.S. gross domestic product (GDP).
- Make up 74 percent of private-sector R&D spending.

As a business student, you have several reasons to be interested in MNEs. Not only can these companies provide interesting work assignments in different locations throughout

the world, but they also frequently offer the highest-paying jobs for college graduates. Even if you don't want to work for an MNE, chances are that the organization you will be working for will do business with one, so it's important to understand how they compete around the globe.

STAGES OF GLOBALIZATION

Since the beginning of the 20th century, globalization has proceeded through three notable stages.[14] Each stage presents a different global strategy pursued by MNEs headquartered in the United States.

GLOBALIZATION 1.0: 1900–1941. Globalization 1.0 took place from about 1900 through the early years of World War II. In that period, basically all the important business functions were located in the home country. Typically, only sales and distribution operations took place overseas—essentially exporting goods to other markets. In some instances, firms procured raw materials from overseas. Strategy formulation and implementation, as well as knowledge flows, followed a one-way path—from domestic headquarters to international outposts. This time period saw the blossoming of the idea of MNEs. It ended with the U.S. entry into World War II.

GLOBALIZATION 2.0: 1945–2000. With the end of World War II came a new focus on growing business—not only to meet the needs that went unfulfilled during the war years but also to reconstruct the damage from the war. From 1945 to the end of the 20th century, in the Globalization 2.0 stage, MNEs began to create smaller, self-contained copies of themselves, with all business functions intact, in a few key countries; notably, Western European countries, Japan, and Australia.

This strategy required significant amounts of foreign direct investment. Although it was costly to duplicate business functions in overseas outposts, doing so allowed for greater local responsiveness to country-specific circumstances. While the U.S. corporate headquarters set overarching strategic goals and allocated resources through the capital budgeting process, local mini-MNE replicas had considerable leeway in day-to-day operations. Knowledge flow back to U.S. headquarters, however, remained limited in most instances.

GLOBALIZATION 3.0: 21ST CENTURY. Since 2001, we are in the Globalization 3.0 stage. One watershed event was China's entry into the World Trade Organization in the same year. The World Trade Organization (WTO) is a global organization overseeing and administering the rules of trade between nations.[15] The goal of the WTO is to help companies conduct their business across borders based on multinational treaties that are negotiated and signed by its 164 member nations.

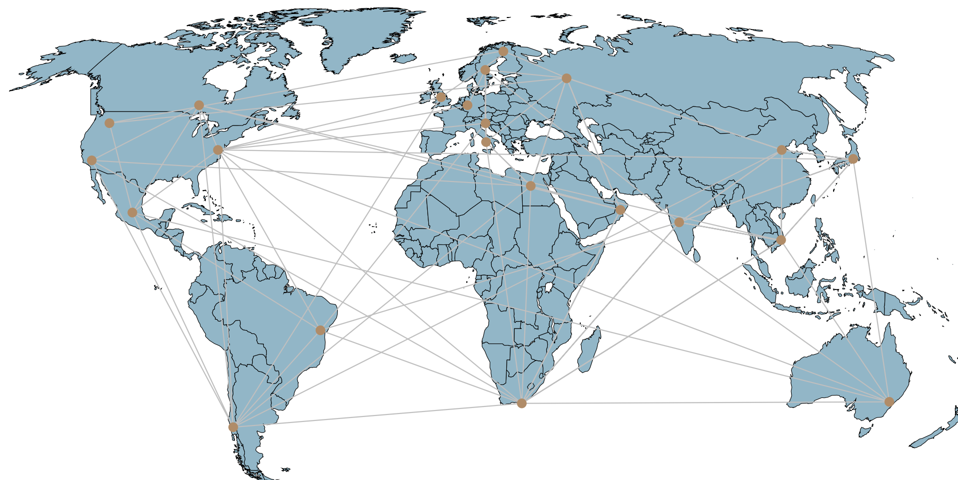
MNEs that had been the vanguard of globalization have since become global collaboration networks (see Exhibit 10.3). Such companies now freely locate business functions anywhere in the world based on an optimal mix of costs, capabilities, and PESTEL factors. Huge investments in fiber-optic cable networks around the world have effectively reduced communication distances, enabling companies to operate 24/7, 365 days a year. When an engineer in Minneapolis, Minnesota, leaves for the evening, an engineer in Mumbai, India, begins her workday. In the Globalization 3.0 stage, the MNE's strategic objective changes. The MNE reorganizes from a multinational company with self-contained operations in a few selected countries to a more seamless global enterprise with centers of expertise. Each of these centers of expertise is a hub within a global network for delivering products and services. Consulting companies, for example, can now tap into a worldwide network of experts in real time, rather than relying on the limited number of employees in their local offices.

EXHIBIT 10.3

Globalization 3.0: 21st Century

Based on an optimal mix of costs, skills, and PESTEL factors, MNEs are organized as global collaboration networks that perform business functions throughout the world.

SOURCE: Adapted from "A Decade of Generating Higher Value at IBM," www.ibm.com, 2009.



Creating a global network of local expertise is beneficial not only in service industries, but also in the industrial sector. To increase the rate of low-cost innovation that can then be used to disrupt existing markets, GE organizes local growth teams in China, India, Kenya, and many other emerging countries.[16] GE uses the slogan "in country, for country" to describe the local growth teams' autonomy in deciding which products and services to develop, how to make them, and how to shape the business model. Many of these low-cost innovations, first developed to serve local needs, are later introduced in Western markets to become disruptive innovations. Examples include the Vscan, a handheld ultrasound device developed in China; the MAC 400, an ECG device developed in India (details follow later); and the 9100c, an anesthesia system developed in Kenya.[17]

Some new ventures organize as global collaboration networks from the start. Logitech, the maker of wireless peripherals such as computer mice, presentation "clickers," and video game controllers, started in Switzerland but quickly established offices in Silicon Valley, California.[18] Pursuing a global strategy right from the start allowed Logitech to tap into the innovation expertise contained in Silicon Valley.[19] In 2016, Logitech had sales of over $2 billion, with offices throughout the Americas, Asia, and Europe. Underlying Logitech's innovation competence is a network of best-in-class skills around the globe. Based on its geographic presence, Logitech can organize work continuously because its teams in different locations around the globe can work 24/7.

Indeed, the trend toward global collaboration networks during the Globalization 3.0 stage raises the interesting question, "What defines a U.S. company?" If it's the address of the headquarters, then IBM, GE, and others are U.S. companies—despite the fact that a majority of their employees work outside the United States. In many instances, the majority of their revenues also come from outside the United States. On the other hand, non-U.S. companies such as carmakers from Japan (Toyota, Honda, and Nissan) and South Korea (Hyundai and Kia) and several engineering companies (Siemens from Germany, and ABB, a Swiss-Swedish MNE) all have made significant investments in the United States and created a large number of well-paying jobs.

STATE OF GLOBALIZATION

Before we delve deeper into the question of why and how firms compete for advantage globally, a cautionary note concerning *globalization* is in order. Although many large firms are more than 50 percent globalized—meaning that more than half of their revenues are from outside the home country—the world itself is far less global.[20] If we look at a number

of different indicators, the level of globalization is no more than 10 to 25 percent. For example, only

- 2 percent of all voice-calling minutes are cross-border.[21]
- 3 percent of the world's population are first-generation immigrants.
- 9 percent of all investments in the economy are foreign direct investments.
- 15 percent of patents list at least one foreign inventor.
- 18 percent of internet traffic crosses national borders.

These data indicate that the world is not quite flat yet,[22] or fully globalized, but at best *semi-globalized.* Pankaj Ghemawat reasons that many more gains in social welfare and living standards can be had through further globalization if future integration is managed effectively through coordinated efforts by governments.[23]

The European Union is an example of coordinated economic and political integration by 28 countries (reduced to 27 after Brexit negotiations are finalized, expected in 2019), of which 19 use the euro as a common currency. This coordinated integration took place over several decades following World War II, precisely to prevent future wars in Europe. The EU encompasses 500 million people, which makes it one of the largest economic zones in the world. Indeed its GDP is a little bit larger than the United States, the largest single-country market in the world. Although the EU has monetary authority administered through the European Central Bank, it does not have fiscal (i.e., budgetary) authority. This important responsibility remains with national governments. This separation between monetary and fiscal authority allowed the sovereign debt crisis during 2009–2015 to emerge.

Continued economic development across the globe has two consequences for MNEs. First, rising wages and other costs are likely to negate any benefits of access to low-cost input factors. Second, as the standard of living rises in emerging economies, MNEs are hoping that increased purchasing power will enable workers to purchase the products they used to make for export only.[24] China's labor costs, for example, are steadily rising in tandem with an improved standard of living, especially in the coastal regions, where wages have risen 50 percent since 2005.

Some MNEs have boosted wages an extra 30 percent following labor unrest in recent years. Many now offer bonuses to blue-collar workers and are taking other measures to avoid sweatshop allegations that have plagued companies such as Nike, Apple, and Levi Strauss. Rising wages, fewer workers due to the effects of China's one-child-per-family policy, and appreciation of the Chinese currency now combine to lessen the country's advantage in low-cost manufacturing.[25] This shift is in alignment with the Chinese government's economic policy, which wants to see a move from "Made in China" to "Designed in China," to capture more of the value added.[26] For instance, the value added of manufacturing an iPhone by Foxconn in China is only about 5 percent.[27]

GLOBALIZATION 3.1: RETRENCHMENT? Several *black swan events* (that is, highly improbable, but high-impact events) have buffeted the world economy in recent years. The global financial crisis between 2008 and 2010 led to a deep recession and high unemployment in many parts of the world, including the United States. At the same time, the European sovereign debt crisis unfolded with several countries teetering on the verge of insolvency, leading to high unemployment in some countries. For instance, about 50 percent of the people under 25 were unemployed in Spain and Greece. In the 2010s, the European refugee crisis unfolded with millions of people being displaced. Fleeing civil war zones as well as territory occupied by the Islamic State, over 1.3 million refugees in 2015 alone streamed into the European Union. While the crises in the United States and the EU unfolded, China continued to rise both in economic and political power, establishing itself as a superpower

to be reckoned with, potentially challenging the supremacy of the United States. Other countries, such as Russia and Turkey, appear to become more autocratic as time unfolds.

All of these macro events contributed to a rise of nationalism in the United States and Western Europe. In 2016, the British voted to leave the European Union. Right-wing parties registered strong gains in national elections in many European countries. Meanwhile, in the United States, during his inaugural speech in 2017, President Donald Trump proclaimed an "America first" policy.

As a consequence, globalization is currently undergoing some retrenchment with a stronger focus on nationalism. Rather than multinational trade deals negotiated by international bodies such as the WTO, bilateral treaties between countries are in vogue. The future viability of entire economic trading blocs such as the European Union or NAFTA are being questioned. Any resulting changes would likely affect cross-border trade in a negative fashion, impacting MNEs the most. It remains to be seen whether such sentiments will have lasting consequences over the next few years as this process of potential globalization retrenchment unfolds.

10.2 Going Global: Why?

LO 10-2

Explain why companies compete abroad, and evaluate the advantages and disadvantages of going global.

The decision to pursue international expansion results from the firm's assessment that doing so enhances its competitive advantage and that the benefits of globalization exceed the costs. Simply put, firms expand beyond their domestic borders if they can increase their economic value creation ($V - C$) and enhance competitive advantage. As detailed in Chapter 5, firms enlarge their competitive advantage by increasing a consumer's willingness to pay through higher perceived value based on differentiation and/or lower production and service delivery costs. Expanding beyond the home market, therefore, should reinforce a company's basis of competitive advantage—whether differentiation, low-cost, or value innovation. Here we consider both the advantages and disadvantages of expanding beyond the home market (see Exhibit 10.4).

ADVANTAGES OF GOING GLOBAL

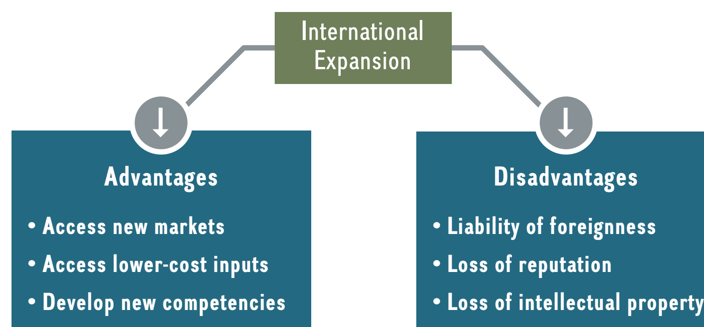
Why do firms expand internationally? The main reasons firms expand abroad are to

- Gain access to a larger market.
- Gain access to low-cost input factors.
- Develop new competencies.

GAIN ACCESS TO A LARGER MARKET. Becoming an MNE provides significant opportunities for companies, given *economies of scale* and *scope* that can be reaped by participating

EXHIBIT 10.4

Advantages and Disadvantages of International Expansion



Strategy Highlight 10.1

The Gulf Airlines Are Landing in the United States

Fasten your seat belts, Delta, American, and United. Severe turbulence may be ahead.

New entrants into both the domestic and international routes are increasing the competitive pressure on U.S. legacy air carriers. Three airlines—Emirates, Etihad Airways, and Qatar Airways—all from the Persian Gulf, are using a blue ocean strategy to attract new customers. The Gulf carriers offer higher quality at lower cost to break into international routes, the last remaining profit sanctuary of U.S. carriers. The legacy carriers have long been squeezed domestically by low-cost competitors such as Southwest, Frontier, Spirit, and others (see Strategy Highlight 3.2). Although most of the future growth is in Asia, the United States remains the world's largest air traffic market, still holding on to one-third of all business.

But look at the latest U.S. competitors. The Gulf carriers make flying enjoyable again, getting away from the Greyhound bus feel adopted by U.S. carriers to drive down costs. At many U.S. airlines, service has deteriorated as air travel has become a commodity, and price has become the main competitive weapon. A high-profile incident in 2017, as an already seated United Airlines passenger was removed by force to make room for late-arriving crew members hitching a ride, epitomized the service crisis in U.S. air travel. Caught on video by smartphones, the incident went viral, receiving global attention. Qatar Airways, one of the Gulf carriers, was quick to update its smartphone app to say that it "doesn't support drag and drop of passengers."

An Emirates A-380 superjumbo jet takes off en route to the United States, flying past the famous Burj Al Arab hotel in Dubai, United Arab Emirates.

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The Gulf airlines bring back some of the service and glamour that used to be associated with air travel. They offer amenities such as higher-quality complimentary meals and hot towels in economy, in addition, to an open bar in business class, and private suites with showers in first class. Their ratio of flight attendants to passengers is also greater, including offering flying nannies to keep kids occupied, happy, and most importantly not crying. In their home base, they build airports reminiscent of luxury hotels with swimming pools above the concourse for laps during layovers, high-speed Wi-Fi, high-end conference rooms with the latest audiovisual equipment, plush lounges, and many other amenities.

Given their location on the Persian peninsula, the Gulf airlines offer direct flights to major hubs in Europe, Asia, and the United States, using the newest and most modern aircraft. Their reach via direct flights extends to about 80 percent of the world's population. In particular, the Gulf carriers are already connecting Europe and Asia, having taken away major business from European airlines such as Lufthansa of Germany and British Airways. These so-called super-connectors already dominate the long-distance route between Europe and Asia, growing its passengers threefold over the past decade. Moreover, traditional international airport hubs such as London, Frankfurt, and Amsterdam all have lost a large share of their business to the new luxury hubs in Dubai, Abu Dhabi, and Doha. The Gulf carriers are now attempting to repeat this feat in the United States, offering direct flights to many U.S. cities including Atlanta, Boston, Chicago, Dallas, Houston, Los Angeles, Miami, New York, Philadelphia, San Francisco, Seattle, Orlando, and Washington, D.C.

(continued)

U.S. carriers have complained that the Persian Gulf airlines receive unfair subsidies. CEOs of U.S. carriers have turned to politicians in Washington to stem the onslaught of the Gulf carriers. Customers, however, are voting with their wallets by flocking to the Gulf carriers, enjoying competitive prices and a better service experience. Moreover, the Gulf carriers counter that U.S. airlines have long enjoyed tightly regulated markets, restricting foreign competition. Moreover, they also remind the public that each of the U.S. legacy carriers has used bankruptcy filings to obtain debt relief, and that some legacy carriers received government bailouts. They suggest that the investments made by the government owners of the Persian Gulf carriers are merely equity investments as done by other stockholders.

Yet even the Gulf carriers are experiencing headwinds lately. Given the 50 percent decline in oil prices since 2014, other international airlines have become more cost-competitive. In addition, economic performance in the Gulf region is tightly linked to the price of oil. With falling oil prices, the spending power of companies in the region drops, and with it demand for business travel, the most profitable segment for airlines. A series of terrorist attacks at airports in the Middle East as well as the downing of a Russian passenger jet by a bomb in the region have contributed to a sharp decline in air travel to and from the Middle East, including to the super-connector hubs. Finally, restrictions imposed by the American government on airlines flying from the region directly into the United States, such as a laptop ban on board, have redirected demand for air travel to European carriers, departing from Frankfurt, Amsterdam, London, or Paris.

One thing seems clear, however; the competitive pressure by the Gulf carriers on U.S. legacy carriers is likely to get stronger. The Persian Gulf states have decided that international air travel is a strategic future industry for the region. To back up their intent, the carriers made strong strategic commitments, not only by building the most modern and luxurious airports in the world, but also by locking up about half of the airframe makers' future production capacity. In particular, they ordered new super-modern, long-range airplanes made by Boeing (such as the new 787 Dreamliner) and Airbus (such as the A-380, the superjumbo). The Gulf carriers are already the fastest-growing airlines globally, yet they continue to push into larger markets and more attractive routes. In the meantime, consumers enjoy the benefits of globalization: more choice, more routes, better service and amenities, as well as lower prices.[28]

in a much larger market. Companies that base their competitive advantage on *economies of scale* and *economies of scope* have an incentive to gain access to larger markets because this can reinforce the basis of their competitive advantage. This in turn allows MNEs to out-compete local rivals. In Strategy Highlight 6.1, we detailed how Narayana Health, a specialty hospital chain in India, founded and led by Dr. Devi Shetty, obtained a low-cost competitive advantage in complex procedures such as open-heart surgery. Narayana Health is now leveraging its low-cost, high-quality position by opening specialty hospitals in the Cayman Islands (to serve U.S. patients) and Kuala Lumpur, Malaysia.

At the same time, some countries with relatively weak domestic demand, such as China, Germany, South Korea, and Japan, focus on export-led economic growth, which drives many of their domestic businesses to become MNEs. For companies based in smaller economies, becoming an MNE may be necessary to achieve growth or to gain and sustain competitive advantage. Examples include Acer (Taiwan), Casella Wines (Australia), IKEA (featured in the ChapterCase), Nestlé (Switzerland), LEGO (Denmark), Philips (Netherlands), Samsung (South Korea), and Zara (Spain). Unless companies in smaller economies expand internationally, their domestic markets are often too small for them to reach significant economies of scale to compete effectively against other MNEs. Strategy Highlight 10.1 shows how the Persian Gulf airlines (all coming from small countries) are entering the much larger U.S. and international markets, competing directly with legacy carriers such as American, Delta, and United.

GAIN ACCESS TO LOW-COST INPUT FACTORS. MNEs that base their competitive advantage on a low-cost leadership strategy are particularly attracted to go overseas to gain

access to low-cost input factors. Access to low-cost raw *materials* such as lumber, iron ore, oil, and coal was a key driver behind Globalization 1.0 and 2.0. During Globalization 3.0, firms have expanded globally to benefit from lower *labor costs* in manufacturing and services. India carved out a competitive advantage in business process outsourcing (BPO), not only because of low-cost labor but also because of an abundance of well-educated, English-speaking young people. Infosys, TCS, and Wipro are some of the more well-known Indian IT service companies. Taken together, these companies employ more than 250,000 people and provide services to many of the Global Fortune 500 companies. Many MNEs have close business ties with Indian IT firms. Some, such as IBM, are engaged in foreign direct investment through equity alliances or building their own IT and customer service centers in India. More than a quarter of Accenture's work force, a consultancy specializing in technology and outsourcing, is now in Bangalore, India.[29] Both the CEOs of Google (Sundar Pichai) and Microsoft (Satya Nadella) hail from India.

Likewise, China has emerged as a manufacturing powerhouse because of low labor costs and an efficient infrastructure. An American manufacturing worker costs about 20 times more in wages alone than a similarly skilled worker in China.[30] A significant cost differential exists not only for low-skilled labor, but for high-skilled labor as well. A Chinese engineer trained at Purdue University, for example, works for only a quarter of the salary in his native country compared with an engineer working in the United States.[31] Of course, this absolute wage disparity also reflects the relative difference in the two countries' cost of living.

DEVELOP NEW COMPETENCIES. Some MNEs pursue a global strategy in order to develop new competencies.[32] This motivation is particularly attractive for firms that base their competitive advantage on a differentiation strategy. These companies are making foreign direct investments to be part of *communities of learning,* which are often contained in specific geographic regions.[33] AstraZeneca, a Swiss-based pharmaceutical company, relocated its research facility to Cambridge, Massachusetts, to be part of the Boston biotech cluster, in hopes of developing new R&D competencies in biotechnology.[34] Cisco invested more than $1.6 billion to create an Asian headquarters in Bangalore and support other locations in India, in order to be in the middle of India's top IT location.[35] Likewise, Microsoft, the third-largest tech company globally (after Apple and Alphabet, Google's parent), has a key research center in Bangalore, India. Unilever's new-concept center is located in downtown Shanghai, China, attracting hundreds of eager volunteers to test the firm's latest product innovations on-site, while Unilever researchers monitor consumer reactions. In these examples, AstraZeneca, Cisco, Microsoft, and Unilever all reap **location economies**—benefits from locating value chain activities in optimal geographies for a specific activity, wherever that may be.[36]

location economies Benefits from locating value chain activities in the world's optimal geographies for a specific activity, wherever that may be.

Many MNEs now are replacing the one-way innovation flow from Western economies to developing markets with a *polycentric innovation strategy*—a strategy in which MNEs now draw on multiple, equally important innovation hubs throughout the world characteristic of Globalization 3.0; see Exhibit 10.3. GE Global Research, for example, orchestrates a "network of excellence" with facilities in Niskayuna, New York (United States); Bangalore (India); Shanghai (China); and Munich (Germany). Indeed, emerging economies are becoming hotbeds for low-cost innovations that find their way back to developed markets.[37] In Bangalore, GE researchers developed the MAC 400, a handheld electrocardiogram (ECG).[38] The device is small, portable, and runs on batteries. Although a conventional ECG machine costs $2,000, this handheld version costs $800 and enables doctors to do an ECG test at a cost of only $1 per patient. The MAC 400 is now entering the United States and other Western markets as a disruptive innovation, with anticipated widespread use in the offices of general practitioners and emergency ambulances.

A GE team in China developed the Vscan, an inexpensive, portable ultrasound device, costing some $5,000— rather than the $250,000 cost of a traditional ultrasound machine used in Western hospitals. The Vscan is now widely used in rural areas of developing countries (as shown here in Vietnam) and has made its entry as a disruptive innovation in the United States and other rich countries.
©Thierry Falise/LightRocket via Getty Images

DISADVANTAGES OF GOING GLOBAL

Companies expanding internationally must carefully weigh the benefits and costs of doing so. If the cost of going global as captured by the following disadvantages exceeds the expected benefits in terms of value added ($C > V$), that is, if the economic value creation is negative, then firms are better off by not expanding internationally. Disadvantages to going global include

- Liability of foreignness.
- Loss of reputation.
- Loss of intellectual property.

LIABILITY OF FOREIGNNESS. In international expansion, firms face risks. In particular, MNEs doing business abroad also must overcome the **liability of foreignness**. This liability consists of the additional costs of doing business in an unfamiliar cultural and economic environment, and of coordinating across geographic distances.[39]

liability of foreignness Additional costs of doing business in an unfamiliar cultural and economic environment, and of coordinating across geographic distances.

For instance, Walmart's problems in several international markets are in large part because of the liability of foreignness. In particular, Walmart failed in Germany and experienced a similar fate in South Korea, where it also exited in 2006. In addition, Walmart has tried for many years to successfully enter the fast-growing markets in Russia and India, but with little or no success. Walmart's success recipe that worked so well domestically didn't work in Germany, South Korea, Russia, or India. Strategy Highlight 10.2 illustrates how Walmart underestimated its liability of foreignness when entering and competing in Germany, and how it is now facing the German grocery industry disruptors, Aldi and Lidl, on its home turf.

LOSS OF REPUTATION. One of the most valuable resources that a firm may possess is its reputation. A firm's reputation can have several dimensions, including a reputation for innovation, customer service, or brand reputation. Apple's brand, for example, stands for innovation and superior customer experience. Apple's reputation is also one of its most important resources. Apple's brand is valued at $230 billion, making it (with Google's) one of the two most valuable brands in the world.[40] We detailed in Chapter 4 that a brand can be the basis for a competitive advantage if it is valuable, rare, and difficult to imitate.

While cost savings can generally be achieved, globalizing a supply chain can also have unintended side effects. These can lead to a loss of reputation and diminish the MNE's competitiveness. A possible loss in reputation can be a considerable risk and cost for doing business abroad. Because Apple's stellar consumer reputation is critical to its competitive advantage, it should be concerned about any potential negative exposure from its global activities. Problems at Apple's main supplier, Foxconn, brought this concern to the fore.

Low wages, long hours, and poor working and living conditions contributed to a spate of suicides in 2010 at Foxconn, Apple's main supplier in China.[41] The Taiwanese company, which employs more than a million people, manufactures computers, tablets, smartphones, and other consumer electronics for Apple and other leading consumer electronics companies. The backlash against alleged sweatshop conditions in Foxconn prompted Apple to work with its main supplier to improve working conditions and wages. Tim Cook, Apple's CEO, visited Foxconn in China to personally inspect its manufacturing facility and workers' living conditions. Although conditions at Foxconn have been improving,[42]

Strategy Highlight 10.2

Walmart Retreats from Germany, and Lidl Invades the United States

In 2006 and after spending billions of dollars, Walmart exited Germany in defeat. The eight-year failure shocked an otherwise successful company, and ghosts from the debacle now haunt Walmart on its native shores. What went wrong?

In 1998, Walmart faced a saturated U.S. market, and Germany, then the third-largest economy in the world, looked appealing. Walmart was already active in six foreign countries, with some 500 stores. Leadership decided the company's superior U.S. strategy—as the low-cost leader—would travel well one more time.

Walmart acquired Germany's 21-store Wertkauf chain and 74 hypermarkets from German retailer Spar Handels AG. And it followed the U.S. playbook: Walmart cheer, a door greeter, associates always available to customers, smiling and offering help, bagging groceries at the checkout, and so on. German employees, however, declined the transfusion of American values. No door greeters. Employees upheld the usual gruff standard of retail customer service found throughout Germany. Worse, the first Walmart boss in Germany—installed directly from the Arkansas headquarters—spoke no German. He decreed that English would be the official in-house language.

Cultural differences aside, Walmart also failed to keep prices down. The retailer lacked its domestic economies of scale and efficient distribution centers. Moreover, German labor laws—more protective than in the United States—drove up costs. The prices at Walmart in Germany were not "always low" despite the company slogan, but fell in the medium range.

Lastly, Walmart faced serious competition. Germany was already home to retail discount powerhouses such as Aldi and Lidl, with thousands of smaller outlets offering higher convenience combined with lower prices. Then it faced Metro, a large-box retailer, which started a price war when Walmart entered Germany. In the end, a defeated Walmart sold its stores to—guess who?—Metro!

One useful definition of strategy is to answer the question of how to deal with competition.[43] Walmart did not find a good strategy for competing with Aldi and Lidl in Germany. Now, Walmart is worried that Aldi and Lidl will challenge the world's largest retailer on its home turf. Aldi has been competing in the United States since the 1970s with its own Aldi stores (and its Trader Joe's brand). In 2017, Lidl also entered the United States.

Lidl, a German discounter, entered the United States in 2017. Together with Aldi, Lidl disrupted the grocery market in the United Kingdom. Walmart executives are concerned about a repeat in the United States.
©AP Images/Steve Helber

Why does Walmart worry about Lidl's entry into the U.S. grocery business? Aldi has been highly successful with its over 2,000 stores (and another 400-plus Trader Joe's stores) in the United States. Rather than focusing on large big-box outlets, Aldi stores are small, near urban centers with high foot traffic and easy access to public transportation or major roads to suburbia. Moreover, Trader Joe's, as a neighborhood grocery store, has a loyal fan base. It offers mainly its own brand-name products such as organic, vegetarian, or imported foods at much lower prices than Whole Foods and elsewhere. Trader Joe's generates twice as much revenue per square foot of retail space as Whole Foods.

Lidl is joining the fray. It already has a few dozen stores on the U.S. East Coast, with hundreds more planned. Similarly to Aldi, Lidl also competes on price and offers mainly its own store brands. Another advantage: These competitors typically offer 2,000 products rather than the standard 40,000 or so of large supermarkets. For example, many grocery stores sell 30 types of mustard. These German disruptors carry only two. Products arrive shelf-ready, minimizing stocking and inventory costs, albeit often with a wholesale feel. All products are sold at ultra-low prices. There are no daily or weekly specials.

Indeed, the entry of the German discounters was so successful in the United Kingdom that Tesco, Britain's leading supermarket chain, had to close dozens of stores, with large-scale layoffs. Its market cap fell almost 80 percent, from $80 billion in 2007 to as low as $17 billion in 2017.

(continued)

Meanwhile, Walmart prepares. With online sales, Walmart leads the German discounters, although it trails Amazon. Walmart's online sales grew by more than 50 percent in 2017. This growth comes in part from a new "order online, pick up in store" concept, with dedicated parking bays for drive-by customers to pick up online purchases. And it successfully improved Walmart.com, offering free, two-day delivery for orders over $35.

Walmart is also working the basics to speed up checkout times and lower some prices even more. And it continues to pressure suppliers so that its prices will be 15 percent lower than the competition's 80 percent of the time. With Amazon on one side (especially after its acquisition of Whole Foods Market) and industry disruptors such as Aldi and Lidl on the other, Walmart is sharpening its strategic position as a low-cost leader. This competitive battle is crucial for Walmart because groceries make up some 60 percent of its annual revenues of $500 billion, making it the largest grocery chain in the United States.[44]

Apple started to diversify its supplier base by adding Pegatron, another Taiwanese original equipment manufacturer (OEM).[45]

MNEs' search for low-cost labor has had tragic effects where local governments are corrupt and unwilling or unable to enforce a minimum of safety standards. The textile industry is notorious for sweatshop conditions, and many Western companies such as the Gap (United States), H&M (Sweden), and Carrefour (France) have taken a big hit to their reputations in factory accidents in Bangladesh and elsewhere in Southeast Asia. Hundreds of factory workers were killed when a textile factory collapsed in Rana Plaza in 2013 on the outskirts of Dhaka, Bangladesh.[46] Although much of the blame lies with the often corrupt host governments not enforcing laws, regulations, and building codes, the MNEs that source their textiles in these factories also receive some of the blame with negative consequences for their reputation. The MNEs are accused of exploiting workers and being indifferent to their working conditions and safety, all in an unending quest to drive down costs.

This challenge directly concerns the MNEs' *corporate social responsibility (CSR),* discussed in Chapter 2. Since some host governments are either unwilling or unable to enforce regulation and safety codes, MNEs need to rise to the challenge.[47] Walmart responded by posting a public list of "banned suppliers" on its website. These are suppliers that do not meet adequate safety standards and working conditions. Before the Rana Plaza accident, Walmart had already launched a working and fire-safety academy in Bangladesh to train textile workers.

Given the regulatory and legal void that local governments often leave, several Western MNEs have proposed a concerted action to finance safety efforts and worker training as well as structural upgrades to factory buildings. After earlier revelations about the frequent practice of child labor in many developing countries, Western MNEs in the textile industry worked together to ban their suppliers from using child labor. Ensuring ethical sourcing of raw materials and supplies is becoming ever more important. Besides a moral responsibility, MNEs have a market incentive to protect their reputations given the public backlash in the wake of factory accidents, child labor, worker suicides, and other horrific externalities.

LOSS OF INTELLECTUAL PROPERTY. Finally, the issue of protecting intellectual property in foreign markets also looms large. The software, movie, and music industries have long lamented large-scale copyright infringements in many foreign markets. In addition, when required to partner with a foreign host firm, companies may find their intellectual property being siphoned off and reverse-engineered.

Japanese and European engineering companies entered China to participate in building the world's largest network of high-speed trains worth billions of dollars.[48] Companies such as Kawasaki Heavy Industries (Japan), Siemens (Germany), and Alstom (France) were joint venture partners with domestic Chinese companies. These firms now allege that the Chinese partners built on the Japanese and European partners' advanced technology

to create their own, next-generation high-speed trains. To make matters worse, they also claim that the Chinese companies now compete against them in other lucrative markets, such as Saudi Arabia, Brazil, and even California, with trains of equal or better capabilities but offered at much lower prices. This example highlights the *intellectual property exposure* that firms can face when expanding overseas.

10.3 Going Global: Where and How?

LO 10-3

Apply the CAGE distance framework to guide MNE decisions on which countries to enter.

After discussing why companies expand internationally, we now turn to the question of how to guide MNE decisions on which countries to enter and how to then enter those countries.

WHERE IN THE WORLD TO COMPETE? THE CAGE DISTANCE FRAMEWORK

The question of where to compete geographically is, following vertical integration and diversification, the third dimension of determining a firm's corporate strategy. The primary driver behind firms expanding beyond their domestic market is to strengthen their competitive position by gaining access to larger markets and low-cost input factors and to develop new competencies. So wouldn't companies choose new markets solely based on measures such as per capita consumption of the product and per capita income?

Yes and no. Consider that several countries and locations can score similarly on such *absolute* metrics of attractiveness. Ireland and Portugal, for example, have similar cost structures, and both provide access to some 500 million customers in the European Union. Both countries use the euro as a common currency, and both have a similarly educated work force and infrastructure. Given these similarities, how does an MNE decide? Rather than looking at absolute measures, MNEs need to consider *relative distance* in the CAGE model.

To aid MNEs in deciding where in the world to compete, Pankaj Ghemawat introduced the **CAGE distance framework**. CAGE is an acronym for different kinds of distance:

CAGE distance framework A decision framework based on the relative distance between home and a foreign target country along four dimensions: cultural distance, administrative and political distance, geographic distance, and economic distance.

- **C**ultural.
- **A**dministrative and political.
- **G**eographic.
- **E**conomic.[49]

Most of the costs and risks involved in expanding beyond the domestic market are created by *distance*. Distance not only denotes geographic distance (in miles or kilometers), but also includes, as the CAGE acronym points out, cultural distance, administrative and political distance, and economic distance. The CAGE distance framework breaks distance into different relative components between any two country pairs that affect the success of FDI.

Although absolute metrics such as country wealth or market size matter to some extent—as we know, for example, that a 1 percent increase in country wealth leads to a 0.8 percent increase in international trade—the relative factors captured by the CAGE distance model matter more. For instance, countries that are 5,000 miles apart trade only 20 percent of the amount traded among countries that are 1,000 miles apart. Cultural distance matters even more. A common language increases trade between two countries by 200 percent over country pairs without one. Thus, in the earlier example regarding which EU country to select for FDI, a U.S. MNE should pick Ireland, while a Brazilian MNE should select Portugal. In the latter case, Brazil and Portugal also share a historic colony–colonizer

EXHIBIT 10.5 The CAGE Distance Framework

Distance	C Cultural	A Administrative and Political	G Geographic	E Economic
Between two countries increases with . . .	• Different languages, ethnicities, religions, social norms, and dispositions • Lack of connective ethnic or social networks • Lack of trust and mutual respect	• Absence of trading bloc • Absence of shared currency, monetary or political association • Absence of colonial ties • Political hostilities • Weak legal and financial institutions	• Lack of common border, waterway access, adequate transportation, or communication links • Physical remoteness • Different climates and time zones	• Different consumer incomes • Different costs and quality of natural, financial, and human resources • Different information or knowledge
Most affects industries or products . . .	• With high linguistic content (TV) • Related to national and/or religious identity (foods) • Carrying country-specific quality associations (wines)	• That a foreign government views as staples (electricity), as building national reputations (aerospace), or as vital to national security (telecommunications)	• With low value-to-weight ratio (cement) • That are fragile or perishable (glass, meats) • In which communications are vital (financial services)	• For which demand varies by income (cars) • In which labor and other cost differences matter (textiles)

SOURCE: Adapted from P. Ghemawat (2001), "Distance still matters: The hard reality of global expansion," *Harvard Business Review*, September: 137–147.

relationship. This link increases the expected trade intensity between these two countries by yet another 900 percent in comparison to country pairs where absent.

Other CAGE distance factors are significant in predicting the amount of trade between two countries. If the countries belong to the same regional trading bloc, they can expect another 330 percent in trade intensity. Examples include the United States, Canada, and Mexico in NAFTA, or the member states of the European Union. If the two countries use the same currency it increases trade intensity by 340 percent. An example is use of the euro as the common currency in 19 EU countries.[50]

Exhibit 10.5 presents the CAGE distance model. In particular, it details factors that increase the overall distance between the two countries and how distance affects different industries or products along the CAGE dimensions.[51] Next, we briefly discuss each of the CAGE distance dimensions.[52]

national culture The collective mental and emotional "programming of the mind" that differentiates human groups.

CULTURAL DISTANCE. In his seminal research, Geert Hofstede defined and measured **national culture**, the collective mental and emotional "programming of the mind" that differentiates human groups.[53] Culture is made up of a collection of social norms and mores, beliefs, and values. Culture captures the often unwritten and implicitly understood rules of the game.

Although there is no one-size-fits-all culture that accurately describes any nation, Hofstede's work provides a useful tool to proxy cultural distance. Based on data analysis

from more than 100,000 individuals from many different countries, four main dimensions of culture emerged: *Power distance, individualism, masculinity–femininity,* and *uncertainty avoidance.*[54] Hofstede's data analysis yielded scores for the different countries, for each dimension, on a range of zero to 100, with 100 as the high end. More recently, Hofstede added two additional cultural dimensions: *long-term orientation* and *indulgence.*[55]

Cultural differences find their expression in language, ethnicity, religion, and social norms. They directly affect customer preferences (see Exhibit 10.5). Because of religious beliefs, for example, Hindus do not eat beef, while Muslims do not eat pork. In terms of content-intensive service, cultural and language differences are also the reason global internet companies such as Amazon or Google offer country-specific variations of their sites. Despite these best efforts, they are often outflanked by native providers because of their deeper cultural understanding. For example, in China the leading websites are domestic ones: Alibaba in ecommerce, and Baidu in online search. In Russia, the leading ecommerce site is Ozon, while the leading search engine is Yandex.

cultural distance Cultural disparity between an internationally expanding firm's home country and its targeted host country.

Hofstede's national-culture research becomes even more useful for managers by combining the distinct dimensions of culture into an aggregate measure for each country. MNEs then can compare the national-culture measures for any two country pairings to inform their entry decisions.[56] The difference between scores indicates **cultural distance**, the cultural disparity between the internationally expanding firm's home country and its targeted host country. A firm's decision to enter certain international markets is influenced by cultural differences. A greater cultural distance can increase the cost and uncertainty of conducting business abroad. In short, greater cultural distance increases the liability of foreignness.

If we calculate the cultural distance from the United States to various countries, for example, we find that some countries are culturally very close to the United States. Australia, for example, has an overall cultural distance score of 0.02. Others are culturally quite distant. Russia has an overall cultural distance score of 4.42. As can be expected, English-speaking countries such as Canada (0.12), Ireland (0.35), New Zealand (0.26), and the United Kingdom (0.09) all exhibit a low cultural distance to the United States. Since culture is embedded in language, it comes as no surprise that cultural and linguistic differences are highly correlated.

In 2000 when Starbucks entered the Chinese market, it moved fast to overcome cultural barriers by handing out key chains to help new customers order! Now it leverages Chinese approaches to social media (WeChat, Weibo, and Jiepang) and fine-tunes its own mobile apps and loyalty programs to lure China's growing middle class. The result? Today China is its second-largest market and growing.[58]
Courtesy of Resonance China

Culture even matters in the age of Facebook with its global reach of 2 billion users. Most Facebook friends are local rather than across borders. This makes sense when one considers that the online social graph that Facebook users develop in their network of friends is actually a virtual network laid above a (pre)existing social network, rather than forming one anew.[57]

ADMINISTRATIVE AND POLITICAL DISTANCE. Administrative and political distances are captured in factors such as the absence or presence of shared monetary or political associations, political hostilities, and weak or strong legal and financial institutions.[59]

The 19 European countries in the eurozone, for example, not only share the same currency but also integrate politically to some extent. It should come as no surprise then that most cross-border trade between European countries takes place within the EU. Germany, one of the world's largest exporters, conducts roughly 75 percent of its cross-border business within the EU.[60] Similarly, Canada and Mexico partner with the United States in the North American Free Trade Agreement (NAFTA), increasing trade in goods and services between the three countries. As a result, United States is the largest trading partner for both Canada and Mexico. After China, Canada and Mexico are the largest trading partners for the United States. Colony–colonizer relationships also have a strong positive effect on bilateral trade between countries. British companies continue to trade heavily with businesses from its former colonies in the commonwealth; Spanish companies trade heavily with Latin American countries; and French businesses trade with the franc zone of West Africa.

Many foreign (target) countries also erect other political and administrative barriers, such as tariffs, trade quotas, FDI restrictions, and so forth, to protect domestic competitors. In many instances, China, for example, requests the sharing of technology in a joint venture when entering the country. This was the case in the high-speed train developments discussed earlier. Other countries, including the United States and EU members, protect national champions such as Boeing or Airbus from foreign competition. Industries that are considered critical to national security—domestic airlines or telecommunications—are often protected. Finally, strong legal and ethical pillars as well as well-functioning economic institutions such as capital markets and an independent central bank reduce distance. Strong institutions, both formal and informal, reduce uncertainty and thus reduce transaction costs.[61]

GEOGRAPHIC DISTANCE. The costs to cross-border trade rise with geographic distance. It is important to note, however, that geographic distance does not simply capture how far two countries are from each other but also includes additional attributes, such as the country's physical size (Canada versus Singapore), the within-country distances to its borders, the country's topography, its time zones, and whether the countries are contiguous to one another or have access to waterways and the ocean. The country's infrastructure, including road, power, and telecommunications networks, also plays a role in determining geographic distance. Geographic distance is particularly relevant when trading products with low value-to-weight ratios, such as steel, cement, or other bulk products, and fragile and perishable products, such as glass or fresh meats and fruits.

ECONOMIC DISTANCE. The wealth and per capita income of consumers is the most important determinant of economic distance. Wealthy countries engage in relatively more cross-border trade than poorer ones. Rich countries tend to trade with other rich countries; in addition, poor countries also trade more frequently with rich countries than with other poor countries. Companies from wealthy countries benefit in cross-border trade with other wealthy countries when their competitive advantage is based on *economies of experience, scale, scope,* and *standardization.* This is because replication of an existing business model is much easier in a country where the incomes are relatively similar and resources, complements, and infrastructure are of roughly equal quality. Although Walmart in Canada is a virtual carbon copy of the Walmart in the United States, Walmart in China is quite different.[62]

Companies from wealthy countries also trade with companies from poor countries to benefit from *economic arbitrage.* The textile industry (discussed earlier) is a prime example. We also highlighted economic arbitrage as one of the main benefits of going global: access to low-cost input factors.

In conclusion, although the CAGE distance framework helps determine the attractiveness of foreign target markets in a more fine-grained manner based on relative differences,

it is necessarily only a first step. A deeper analysis requires looking inside the firm (as done in Chapter 4) to see how a firm's strengths and weaknesses work to increase or reduce distance from specific foreign markets. A company with a large cadre of cosmopolitan managers and a diverse work force will be much less affected by cultural differences, for example, than a company with a more insular and less diverse culture with all managers from the home country. Although technology may make the world seem smaller, the costs of distance along all its dimensions are real. The costs of distance in expanding internationally are often very high. Ignoring these costs can be expensive (see Walmart's adventure in Germany, discussed in Strategy Highlight 10.2) and can lead to a competitive disadvantage.

HOW DO MNES ENTER FOREIGN MARKETS?

LO 10-4

Compare and contrast the different options MNEs have to enter foreign markets.

Assuming an MNE has decided why and where to enter a foreign market, the remaining decision is *how* to do so. Exhibit 10.6 displays the different options managers have when entering foreign markets, along with the required investments necessary and the control they can exert. On the left end of the continuum in Exhibit 10.6 are vehicles of foreign expansion that require low investments but also allow for a low level of control. On the right are foreign-entry modes that require a high level of investments in terms of capital and other resources, but also allow for a high level of control. Foreign-entry modes with a high level of control such as foreign acquisitions or greenfield plants reduce the firm's exposure to two particular downsides of global business: loss of reputation and loss of intellectual property.

Exporting—producing goods in one country to sell in another—is one of the oldest forms of internationalization (part of Globalization 1.0). It is often used to test whether a foreign market is ready for a firm's products. When studying vertical integration and diversification (in Chapter 8), we discussed in detail different forms along the make-or-buy continuum. As discussed in Chapter 9, strategic alliances (including licensing, franchising, and joint ventures) and acquisitions are popular vehicles for entry into foreign markets. Since we discussed these organizational arrangements in detail in previous chapters, we therefore keep this section on foreign-entry modes brief.

The framework illustrated in Exhibit 10.6, moving from left to right, has been suggested as a *stage model* of sequential commitment to a foreign market over time.[63] Though it does not apply to globally born companies, it is relevant for manufacturing companies that are just now expanding into global operations. In some instances, companies are required by the host country to form joint ventures in order to conduct business there, while some MNEs prefer *greenfield operations*—building new, fully owned plants and facilities from scratch, as Motorola did when it entered China in the 1990s.[64]

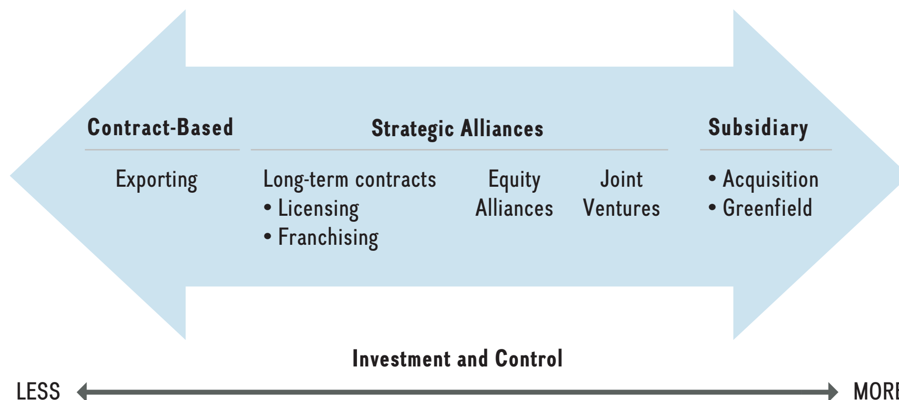


EXHIBIT 10.6 Modes of Foreign-Market Entry along the Investment and Control Continuum

LO 10-5

Apply the integration-responsiveness framework to evaluate the four different strategies MNEs can pursue when competing globally.

10.4 Cost Reductions vs. Local Responsiveness: The Integration-Responsiveness Framework

MNEs face two opposing forces when competing around the globe: *cost reductions* versus *local responsiveness.* Indeed, cost reductions achieved through a global-standardization strategy often reinforce a cost-leadership strategy at the business level. Similarly, local responsiveness increases the differentiation of products and services, reinforcing a differentiation strategy at the business level. Taken together, however, cost reductions and local responsiveness present strategic trade-offs because higher local responsiveness frequently goes along with higher costs. Conversely, a focus on cost reductions does not allow for much local responsiveness. Just like low cost and differentiation at the business strategy level, cost reductions and local responsiveness are trade-offs when competing globally.

globalization hypothesis Assumption that consumer needs and preferences throughout the world are converging and thus becoming increasingly homogenous.

One of the core drivers for globalization is to expand the total market of firms in order to achieve economies of scale and drive down costs. For many business executives, the move toward globalization is based on the **globalization hypothesis**, which states that consumer needs and preferences throughout the world are converging and thus becoming increasingly homogenous. Theodore Levitt stated: "Nothing confirms [the globalization hypothesis] as much as the success of McDonald's from [the] Champs-Élysées to Ginza, of Coca-Cola in Bahrain and Pepsi-Cola in Moscow, and of rock music, Greek salad, Hollywood movies, Revlon cosmetics, Sony televisions, and Levi jeans everywhere."[65] In support of the globalization hypothesis, IKEA, as featured in the ChapterCase, sells its home furnishings successfully in over 40 countries. Toyota is selling its hybrid Prius vehicle in 80 countries. Most vehicles today are built on global platforms and modified (sometimes only cosmetically) to meet local tastes and standards.

The strategic foundations of the globalization hypothesis are based primarily on cost reduction. Lower cost is a key competitive weapon, and MNEs attempt to reap significant cost reductions by leveraging economies of scale and by managing global supply chains to access the lowest-cost input factors.

local responsiveness The need to tailor product and service offerings to fit local consumer preferences and host-country requirements.

Although there seems to be some convergence of consumer preferences across the globe, national differences remain, due to distinct institutions and cultures. For example, in the 1990s, Ford Motor Co. followed this one-size-fits-all strategy by offering a more or less identical car throughout the world: the Ford Mondeo, sold as the Ford Contour and the Mercury Mystique in North America. Ford learned the hard way, by lack of sales, that consumers did not subscribe to the globalization hypothesis at the same level as the Ford executives and were not yet prepared to ignore regional differences.[66] In some instances, MNEs experience pressure for **local responsiveness**—the need to tailor product and service offerings to fit local consumer preferences and host-country requirements; it generally entails higher costs. Walmart sells live animals (snakes, eels, toads, etc.) for food preparation in China. IKEA sells kimchi refrigerators and metal chopsticks in South Korea. McDonald's uses chicken and fish instead of beef in India and offers a teriyaki burger in Japan, even though its basic business model of offering fast food remains the same the world over. Local responsiveness generally entails higher cost, and sometimes even outweighs cost advantages from economies of scale and lower-cost input factors.

integration-responsiveness framework Strategy framework that juxtaposes the pressures an MNE faces for cost reductions and local responsiveness to derive four different strategies to gain and sustain competitive advantage when competing globally.

Given the two opposing pressures of cost reductions versus local responsiveness, scholars have advanced the **integration-responsiveness framework**, shown in Exhibit 10.7.[67] This framework juxtaposes the opposing pressures for cost reductions and local responsiveness to derive four different strategic positions to gain and sustain competitive advantage when competing globally. The four strategic positions, which we will discuss in the following sections, are

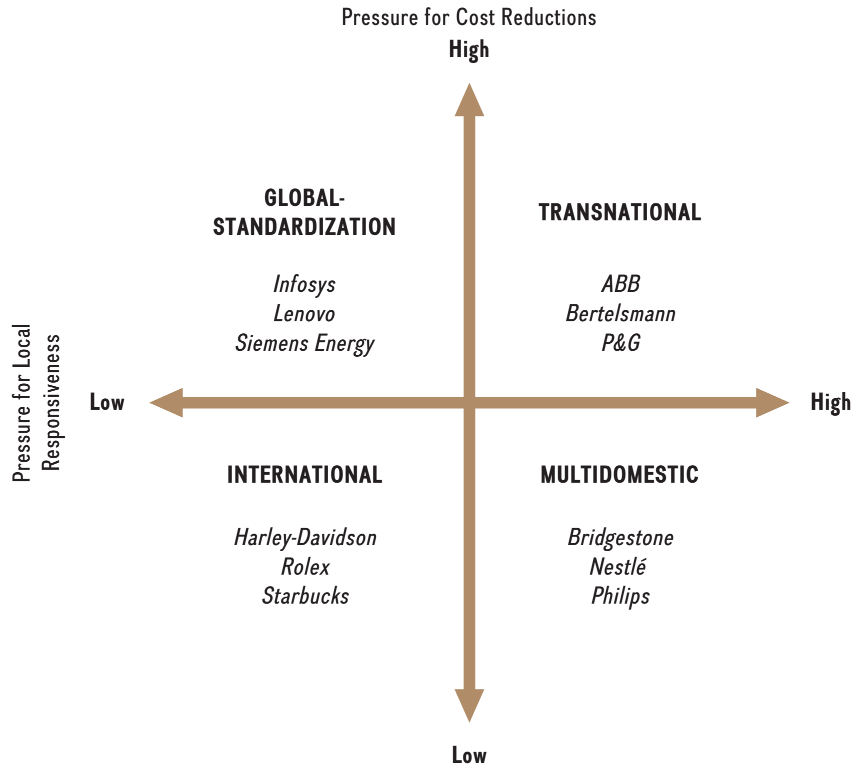


EXHIBIT 10.7 The Integration-Responsiveness Framework: Global Strategy Positions and Representative MNEs

SOURCES: C.K. Prahalad and Y.L. Doz (1987), *The Multinational Mission* (New York: Free Press); and K. Roth and A.J. Morrison (1991), "An empirical analysis of the integration-responsiveness framework in global industries," *Journal of International Business Studies* 21: 541–564.

- International
- Multidomestic
- Global-standardization
- Transnational[68]

At the end of that discussion, Exhibit 10.9 summarizes each global strategy.

INTERNATIONAL STRATEGY

An **international strategy** is essentially a strategy in which a company sells the same products or services in both domestic and foreign markets. It enables MNEs to leverage their home-based core competencies in foreign markets. An international strategy is one of the oldest types of global strategies (Globalization 1.0) and is frequently the first step companies take when beginning to conduct business abroad. As shown in the integration-responsiveness framework, it is advantageous when the MNE faces low pressures for both local responsiveness and cost reductions.

international strategy Strategy that involves leveraging home-based core competencies by selling the same products or services in both domestic and foreign markets.

An international strategy is often used successfully by MNEs with relatively large domestic markets and with strong reputations and brand names. These MNEs, capitalizing on the fact that foreign customers want to buy the original product, tend to use differentiation as their preferred business strategy. For example, bikers in Shanghai, China, like their Harley-Davidson motorcycles to roar just like the ones ridden by the Hells Angels in the United States. Similarly, a Brazilian entrepreneur importing machine tools from Germany expects superior engineering and quality. Finally, Apple's latest iPhone model is a desired luxury product and status symbol the world over. An international strategy tends to rely

on exporting or the licensing of products and franchising of services to reap economies of scale by accessing a larger market.

A strength of the international strategy—its limited local responsiveness—is also a weakness in many industries. For example, when an MNE sells its products in foreign markets with little or no change, it leaves itself open to the expropriation of intellectual property (IP). Looking at the MNE's products and services, pirates can reverse-engineer the products to discover the intellectual property embedded in them. In Thailand, for example, a flourishing market for knockoff luxury sports cars (e.g., Ferraris, Lamborghinis, and Porsches) has sprung up.[69] Besides the risk of exposing IP, MNEs following an international strategy are highly affected by exchange-rate fluctuations. Given increasing globalization, however, fewer and fewer markets correspond to this situation—low pressures for local responsiveness *and* cost reductions—that gives rise to the international strategy.

MULTIDOMESTIC STRATEGY

multidomestic strategy Strategy pursued by MNEs that attempts to maximize local responsiveness, with the intent that local consumers will perceive them to be domestic companies.

MNEs pursuing a **multidomestic strategy** attempt to maximize local responsiveness, hoping that local consumers will perceive their products or services as local ones. This strategy arises out of the combination of high pressure for local responsiveness and low pressure for cost reductions. MNEs frequently use a multidomestic strategy when entering host countries with large and/or idiosyncratic domestic markets, such as Japan or Saudi Arabia. This is one of the main strategies MNEs pursued in the Globalization 2.0 stage.

A multidomestic strategy is common in the consumer products and food industries. For example, Swiss-based Nestlé, the largest food company in the world, is known for customizing its product offerings to suit local preferences, tastes, and requirements. Given the strong brand names and core competencies in R&D, and the quality in their consumer products and food industries, it is not surprising that these MNEs generally pursue a differentiation strategy at the business level. An MNE following a multidomestic strategy, in contrast with an international strategy, faces reduced exchange-rate exposure because the majority of the value creation takes place in the host-country business units, which tend to span all functions.

On the downside, a multidomestic strategy is costly and inefficient because it requires the duplication of key business functions across multiple countries. Each country unit tends to be highly autonomous, and the MNE is unable to reap economies of scale or learning across regions. The risk of IP appropriation increases when companies follow a multidomestic strategy. Besides exposing codified knowledge embedded in products, as is the case with an international strategy, a multidomestic strategy also requires exposing tacit knowledge because products are manufactured locally. Tacit knowledge that is at risk of appropriation may include, for example, the process of how to create consumer products of higher perceived quality.

GLOBAL-STANDARDIZATION STRATEGY

global-standardization strategy Strategy attempting to reap significant economies of scale and location economies by pursuing a global division of labor based on wherever best-of-class capabilities reside at the lowest cost.

MNEs following a **global-standardization strategy** attempt to reap significant economies of scale and location economies by pursuing a global division of labor based on wherever best-of-class capabilities reside at the lowest cost. The global-standardization strategy arises out of the combination of high pressure for cost reductions and low pressure for local responsiveness. MNEs using this strategy are often organized as networks (Globalization 3.0). This lets them strive for the lowest-cost position possible. Their business-level strategy tends to be cost leadership. Because there is little or no differentiation or local responsiveness because products are standardized, price becomes the main competitive weapon. To be price competitive, the MNE must maintain a minimum efficient scale (see Chapter 6).

MNEs that manufacture commodity products such as computer hardware or offer services such as business process outsourcing generally pursue a global-standardization

strategy. Lenovo, the Chinese computer manufacturer, is the maker of the ThinkPad line of laptops, which it acquired from IBM in 2005. To keep track of the latest developments in computing, Lenovo's research centers are located in Beijing and Shanghai in China, in Raleigh, North Carolina (in the Research Triangle Park), and in Japan.[70] To benefit from low-cost labor and to be close to its main markets to reduce shipping costs, Lenovo's manufacturing facilities are in Mexico, India, and China. The company describes the benefits of its global-standardization strategy insightfully: "Lenovo organizes its worldwide operations with the view that a truly global company must be able to quickly capitalize on new ideas and opportunities from anywhere. By forgoing a traditional headquarters model and focusing on centers of excellence around the world, Lenovo makes the maximum use of its resources to create the best products in the most efficient and effective way possible."[71]

One of the advantages of the global-standardization strategy—obtaining the lowest cost point possible by minimizing local adaptations—is also one of its key weaknesses. The American MTV network cable channel started out with a global-standardization strategy.[72] The main inputs—music videos by vocal artists—were sourced more or less globally based on the prevailing music hits. MTV reasoned that music videos were a commodity product that would attract worldwide audiences. MTV was wrong! As indicated by the CAGE distance model, cultural distance most affects products with high linguistic content such as TV. Even in a music video channel, audiences have a distinct preference for at least some local content.

Keep in mind that strategic positions are not constant; they can change over time. Consider how MTV changed its strategic positions as it attempted to respond to the pressures for both cost reduction and local responsiveness. At first, MTV followed a global-standardization strategy. To be more responsive to local audiences, MTV then implemented a multidomestic strategy to meet the need for local responsiveness. This led to a loss of scale effects, especially rolling out expensive content over a large installed base of viewers. In a move a few years later, MTV shifted its strategic position away from a multidomestic strategy and is now pursuing a transnational strategy. Exhibit 10.8 tracks how MTV changed strategic positions in its quest for competitive advantage.

TRANSNATIONAL STRATEGY

MNEs pursuing a **transnational strategy** attempt to combine the benefits of a localization strategy (high local responsiveness) with those of a global-standardization strategy (lowest-cost position attainable). This strategy arises out of the combination of high pressure for local responsiveness and high pressure for cost reductions. A transnational strategy is generally used by MNEs that pursue a blue ocean strategy at the business level by attempting to reconcile product and/or service differentiations at low cost.

transnational strategy Strategy that attempts to combine the benefits of a localization strategy (high local responsiveness) with those of a global-standardization strategy (lowest-cost position attainable).

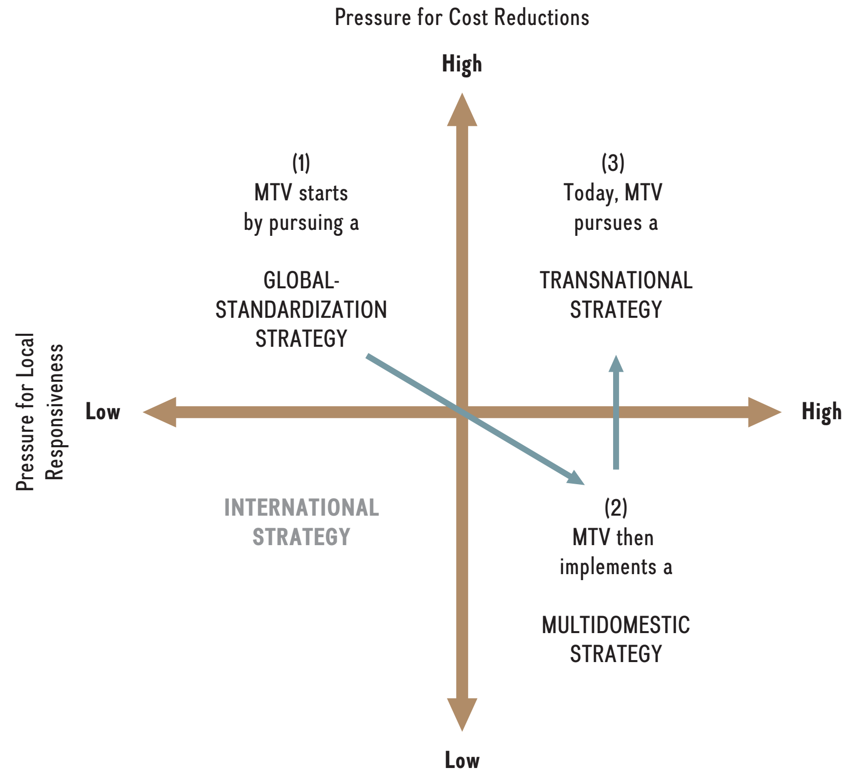
Besides harnessing economies of scale and location, a transnational strategy also aims to benefit from global learning. MNEs typically implement a transnational strategy through a global matrix structure. This organizational structure combines economies of scale along specific product divisions with economies of learning attainable in specific geographic regions. The idea is that best practices, ideas, and innovations will be diffused throughout the world, regardless of their origination. The managers' mantra is to *think globally, but act locally*.

Although a transnational strategy is quite appealing, the required matrix structure is rather difficult to implement because of the organizational complexities involved. High local responsiveness typically requires that key business functions are frequently duplicated in each host country, leading to higher costs. Further compounding the organizational complexities is the challenge of finding managers who can dexterously work across cultures in the ways required by a transnational strategy. We'll discuss organizational structure in more depth in the next chapter.

The German multimedia conglomerate Bertelsmann attempts to follow a transnational strategy. Bertelsmann employs over 100,000 people, with two-thirds of that work force

EXHIBIT 10.8

Dynamic Strategic Positioning: The MTV Music Channel



outside its home country. Bertelsmann operates in more than 60 countries throughout the world and owns many regional leaders in their specific product categories, including Random House Publishing in the United States and RTL Group, Europe's second-largest TV, radio, and production company (after the BBC). Bertelsmann operates its over 500 regional media divisions as more or less autonomous profit-and-loss centers but attempts to share best practices across units; global learning and human resource strategies for executives are coordinated at the network level.[73]

As a summary, Exhibit 10.9 provides a detailed description of each of the four global strategies in the integration-responsiveness framework.

10.5 National Competitive Advantage: World Leadership in Specific Industries

Globalization, the prevalence of the internet with other advances in communications technology, and transportation logistics can lead us to believe that firm location is becoming increasingly less important.[74] Because firms can now, more than ever, source inputs globally, many believe that location must be diminishing in importance as an explanation of firm-level competitive advantage. This idea is called the **death-of-distance hypothesis**.[75]

death-of-distance hypothesis Assumption that geographic location alone should not lead to firm-level competitive advantage because firms are now, more than ever, able to source inputs globally.

Despite an increasingly globalized world, however, it turns out that high-performing firms in certain industries *are* concentrated in specific countries.[76] For example, the leading biotechnology, software, and internet companies are headquartered in the United States. Some of the world's best computer manufacturers are in China and Taiwan. Many of the leading consumer electronics companies are in South Korea and Japan. The top mining companies are in Australia. The leading business process outsourcing (BPO) companies are in India. Some of the best engineering and car companies are in Germany. The world's top fashion designers are in Italy. The best wineries are in France. The list goes on. Although

EXHIBIT 10.9 International, Multidomestic, Global-Standardization, and Transnational Strategies: Characteristics, Benefits, and Risks

Strategy	Characteristics	Benefits	Risks
International	Often the first step in internationalizing. Used by MNEs with relatively large domestic markets or strong exporters (e.g., MNEs from the United States, 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.	Leveraging core competencies. Economies of scale. Low-cost implementation through: • Exporting or licensing (for products) • Franchising (for services) • Licensing (for trademarks)	No or limited local responsiveness. Highly affected by exchange-rate fluctuations. IP embedded in product or service could be expropriated.
Multidomestic	Used by MNEs to compete in host countries with large and/or lucrative but idiosyncratic domestic markets (e.g., Germany, Japan, Saudi Arabia). Often used in consumer products and food industries. Main business-level strategy is differentiation. MNE wants to be perceived as local company.	Highest-possible local responsiveness. Increased differentiation. Reduced exchange-rate exposure.	Duplication of key business functions in multiple countries leads to high cost of implementation. Little or no economies of scale. Little or no learning across different regions. Higher risk of IP expropriation.
Global-Standardization	Used by MNEs that are offering standardized products and services (e.g., computer hardware or business process outsourcing). Main business-level strategy is cost leadership.	Location economies: global division of labor based on wherever best-of-class capabilities reside at lowest cost. Economies of scale and standardization.	No local responsiveness. Little or no product differentiation. Some exchange-rate exposure. "Race to the bottom" as wages increase. Some risk of IP expropriation.
Transnational	Used by MNEs that pursue a blue ocean strategy at the business level by simultaneously focusing on product differentiation and low cost. Mantra: Think globally, act locally.	Attempts to combine benefits of localization and standardization strategies simultaneously by creating a global matrix structure. Economies of scale, location, experience, and learning.	Global matrix structure is costly and difficult to implement, leading to high failure rate. Some exchange-rate exposure. Higher risk of IP expropriation.

globalization lowers the barriers to trade and investments and increases human capital mobility, one key question remains: *Why are certain industries more competitive in some countries than in others?* This question goes to the heart of the issue of **national competitive advantage**, a consideration of world leadership in specific industries. That issue, in

national competitive advantage World leadership in specific industries.

turn, has a direct effect on firm-level competitive advantage. Companies from home countries that are world leaders in specific industries tend to be the strongest competitors globally.

PORTER'S DIAMOND FRAMEWORK

LO 10-6

Apply Porter's diamond framework to explain why certain industries are more competitive in specific nations than in others.

Michael Porter advanced a framework to explain national competitive advantage—why some nations outperform others in specific industries. This framework is called Porter's diamond of national competitive advantage. As shown in Exhibit 10.10, it consists of four interrelated factors:

- Factor conditions.
- Demand conditions.
- Competitive intensity in focal industry.
- Related and supporting industries/complementors.

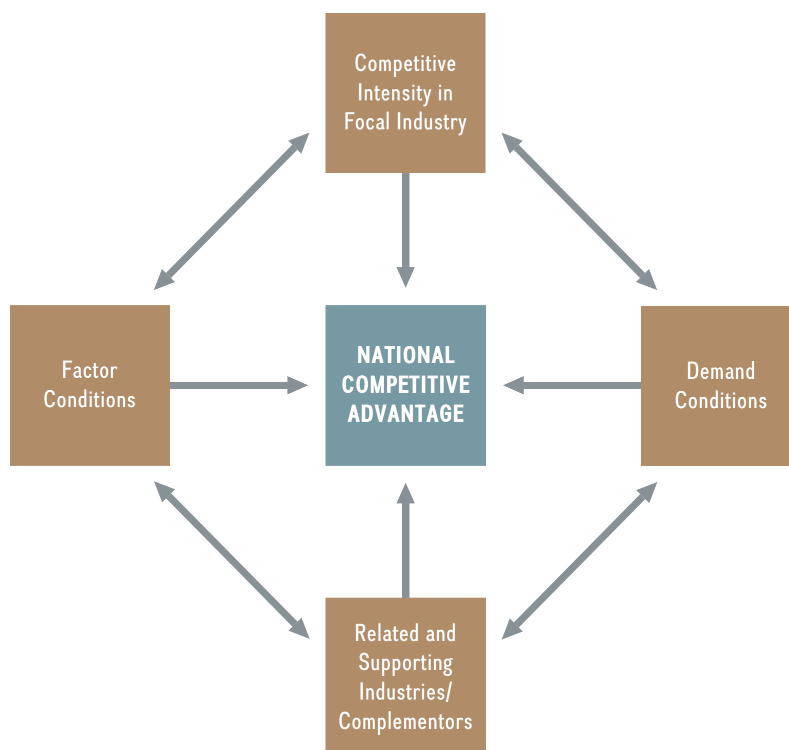
FACTOR CONDITIONS. *Factor conditions* describe a country's endowments in terms of natural, human, and other resources. Other important factors include capital markets, a supportive institutional framework, research universities, and public infrastructure (airports, roads, schools, health care system), among others.

Interestingly, *natural resources* are often not needed to generate world-leading companies, because competitive advantage is often based on other factor endowments such as human capital and know-how. Several of the world's most resource-rich countries (such as Afghanistan,[77] Iran, Iraq, Russia, Saudi Arabia, and Venezuela) are not home to any of the world's leading companies, even though some (though not all) do have in place

EXHIBIT 10.10

Porter's Diamond of National Competitive Advantage

SOURCE: Adapted from M.E. Porter (19901), "The competitive advantage of nations," *Harvard Business Review*, March–April: 78.



institutional frameworks allowing them to be a productive member of world commerce. In contrast, countries that lack natural resources (e.g., Denmark, Finland, Israel, Japan, Singapore, South Korea, Switzerland, Taiwan, and the Netherlands) often develop world-class human capital to compensate.[78]

DEMAND CONDITIONS. *Demand conditions* are the specific characteristics of demand in a firm's domestic market. A home market made up of sophisticated customers who hold companies to a high standard of value creation and cost containment contributes to national competitive advantage. Moreover, demanding customers may also clue firms into the latest developments in specific fields and may push firms to move research from basic findings to commercial applications for the marketplace.

For example, due to dense urban living conditions, hot and humid summers, and high energy costs, it is not surprising that Japanese customers demand small, quiet, and energy-efficient air conditioners. In contrast to the Japanese, Finns have a sparse population living in a more remote countryside. A lack of landlines for telephone service has resulted in the Finnish demand for high-quality wireless services, combined with reliable handsets (and long-life batteries) that can be operated in remote, often hostile, environments. Cell phones have long been a necessity for survival in rural areas of Finland. This situation enabled Nokia to become an early leader in cell phones.[79]

COMPETITIVE INTENSITY IN A FOCAL INDUSTRY. Companies that face a highly competitive environment at home tend to outperform global competitors that lack such intense domestic competition. Fierce domestic competition in Germany, for example, combined with demanding customers and the no-speed-limit autobahn make a tough environment for any car company. Success requires top-notch engineering of chassis and engines, as well as keeping costs and fuel consumption ($6-per-gallon gas) in check. This extremely tough home environment amply prepared German car companies such as Volkswagen (which also owns Audi and Porsche), BMW, and Daimler for global competition.

RELATED AND SUPPORTING INDUSTRIES/COMPLEMENTORS. Leadership in related and supporting industries can also foster world-class competitors in downstream industries. The availability of top-notch *complementors*—firms that provide a good or service that leads customers to value the focal firm's offering more when the two are combined—further strengthens national competitive advantage. Switzerland, for example, leveraged its early lead in industrial chemicals into pharmaceuticals.[80] A sophisticated health care service industry sprang up alongside as an important complementor, to provide further stimulus for growth and continuous improvement and innovation.

The effects of sophisticated customers and highly competitive industries ripple through the industry value chain to create top-notch suppliers and complementors. Toyota's global success in the 1990s and early 2000s was based to a large extent on a network of world-class suppliers in Japan.[81] This tightly knit network allowed for fast two-way knowledge sharing—this in turn improved Toyota's quality and lowered its cost, which it leveraged into a successful blue ocean strategy at the business level.

It is also interesting to note that by 2010, Toyota's supplier advantage had disappeared.[82] It was unable to solve the trade-off between drastically increasing its volume and maintaining superior quality. Toyota's rapid growth in its quest to become the world's leader in volume required quickly bringing on new suppliers outside Japan. Quality standards, however, could not be maintained. Part of the problem lies in path dependence (discussed in Chapter 4), because Chinese and other suppliers could not be found quickly enough, nor could most foreign suppliers build at the required quality levels fast enough. The cultural

distance between Japan and China exacerbated these problems. Combined, these factors explain the quality problems Toyota experienced in recent years, and highlight the importance of related and supporting industries to national competitive advantage.

10.6 Implications for Strategic Leaders

In addition to determining the degree of vertical integration and level of diversification, the strategic leader needs to decide if and how the firm should compete beyond its home market. Decisions along all three dimensions formulate the firm's corporate strategy. Because of increasing global integration in products and services as well as capital markets, the benefits of competing globally outweigh the costs for more and more enterprises. This is true not just for large MNEs, but also for small and medium ones (SMEs). Even small startups are now able to leverage technology such as the internet to compete beyond their home market.

Strategic leaders have a number of frameworks at their disposal to make global strategy decisions. The CAGE framework allows for a detailed analysis of any country pairing. Rather than looking at simple absolute measures such as market size, the strategist can determine the *relative* distance or closeness of a target market to the home market along cultural, administrative/political, geographic, and economic dimensions. Once decided which countries to enter, the *mode* of foreign entry needs to be determined. Considerations of the degree of investment and level of control help in this decision. Higher levels of control, and thus greater protection of IP and a lower likelihood of any loss in reputation, go along with more investment-intensive foreign-entry modes such as acquisitions or greenfield plants (see Exhibit 10.6).

A firm's business-level strategy (discussed in Chapter 6) provides an important clue to possible strategies to be pursued globally. A cost leader, for example, is more likely to have the capabilities to be successful with a global-standardization strategy. In contrast, a differentiator is more likely to be successful in pursuing an international or multidomestic strategy. The same caveats raised concerning a blue ocean strategy at the business level apply at the corporate level: Although attractive on paper, a transnational strategy combining high pressures for cost reductions with high pressures for local responsiveness is difficult to implement because of inherent trade-offs.

Finally, a strategic leader must be aware of the fact that despite globalization and the emergence of the internet, firm geographic location has actually maintained its importance. Critical masses of world-class firms are clearly apparent in *regional geographic clusters*. Think of computer technology firms in Silicon Valley, medical device firms in the Chicago area, and biotechnology firms in and around Boston. This is a worldwide phenomenon. Known for their engineering prowess, car companies such as Daimler, BMW, Audi, and Porsche are clustered in southern Germany. Many fashion-related companies (clothing, shoes, and accessories) are located in northern Italy. Singapore is a well-known cluster for semiconductor materials, and India's leading IT firms are in Bangalore. Porter captures this phenomenon succinctly: "Paradoxically, the enduring competitive advantages in a global economy lie increasingly in local things—knowledge, relationships, and motivation that distant rivals cannot match."[83]

This concludes our discussion of global strategy. Moreover, we have now completed our study of the first two pillars of the AFI framework—*strategy analysis* (Chapters 1 to 5) and *strategy formulation* (Chapters 6 to 10). Next, we turn to the third and final pillar of the AFI framework—*strategy implementation*. In Chapter 11, we'll study what managers can do to implement their carefully crafted strategies successfully and how to avoid failure. In Chapter 12, we study corporate governance and business ethics.

CHAPTERCASE 10 / Consider This. . .

DESPITE ITS TREMENDOUS success, IKEA faces significant challenges going forward. Opening new stores is critical to drive future growth (see Exhibit 10.1). Finding new sources of supply to support more store openings, however, is a challenge. Although demand for IKEA's low-cost home furnishings increased in the aftermath of the global financial crisis as more customers become price-conscious, IKEA's annual store growth has slowed in subsequent years. This is because its supply chain has become a bottleneck. IKEA has difficulty finding suppliers that are a strategic fit with its highly efficient operations. Related to this issue is the fact that wood remains one of IKEA's main input factors, and the world's consumers are becoming more sensitive to the issue of deforestation and its possible link to global warming. In the near future, IKEA must find low-cost replacement materials for wood.

Powerful competitors, moreover, have also taken notice of IKEA's success. Although IKEA is growing in North America, it holds less than 5 percent of the home-furnishings market. To keep IKEA at bay in the United States, Target has recently recruited top designers and launched a wide range of low-priced furnishings. In some European markets, IKEA holds 30 percent market share. IKEA has also been facing issues on the safety front and taken a hit to its corporate reputation. In 2016, IKEA was forced to recall 35 million chests and dressers in the United States and Canada, because they were implicated in the death of several toddlers. Covered widely in the media, the dressers tipped over easily and were not designed to be anchored in a wall. IKEA agreed to a $50 million settlement.

Besides these external challenges, IKEA also faces significant internal ones. Since the company's founding in 1943, no strategic decisions have been made without Ingvar Kamprad's involvement and explicit approval. Kamprad (now in his 90s) in 2013 stepped down from chairing Inter IKEA, the foundation that owns the company. Many observers compare Kamprad's influence on IKEA's culture and organization to that of the legendary Sam Walton at Walmart. Kamprad's three sons are taking on stronger leadership roles at IKEA, including chairing the foundation that controls IKEA. In 2017, IKEA appointed Jesper Brodin, a former assistant to Ingvar Kamprad, as the new CEO.

With new leadership, IKEA is making a major push into online sales. Unlike its competition, IKEA had been slow to compete online, with its chief executive openly accepting that IKEA failed to realize that the internet was not just another fad, but rather a significant disruptor for retailing. IKEA's store traffic and website visits are indicative of this strategic shift. While IKEA's website visits more than doubled within a five-year period (to over 2 billion a year), in-person visits to IKEA stores increased a mere 3 percent a year (to about 1 billion in 2017).

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IKEA also faces some limitations due to its complicated ownership structure. IKEA is privately held through a complex network of foundations and holding companies in the Netherlands, Liechtenstein, and Luxembourg. This arrangement provides benefits in terms of reducing tax exposure, but also creates significant constraints in accessing large sums of capital needed for rapid global expansion. In addition, many EU countries as well as the United States have become increasingly more sensitive to the issue of tax-avoidance schemes by large multinational enterprises.

IKEA will need to address the slew of internal and external challenges to achieve its strategic intent of doubling its number of yearly openings in an attempt to capture a larger slice of fast-growing markets, such as the United States, and to make stronger in-roads in newer markets like China and India. As more and more people are buying furniture online, IKEA now also has to contend with the likes of Amazon, Alibaba, and other online retailers specializing in home furnishings.

Questions

1. List IKEA's external and internal challenges. Looking at IKEA's challenges, which ones do you think pose the greatest threat? Why? How would you address the challenges?
2. Ingvar Kamprad's influence over IKEA may have even been stronger than that of Sam Walton over Walmart because IKEA is a privately held company, whereas Walmart is a public company (since 1970). Walmart entered a period of difficulties after Sam Walton stepped down (in 1988 at age 70). Do you think IKEA had similar difficulties after it endured a similar leadership transition in 2013, when Ingvar Kamprad stepped down? Why or why not?

3. Did it surprise you to learn that both a rich developed country (e.g., the United States and Australia) as well as emerging economies (e.g., China and India) are the fastest-growing international markets for IKEA? Does this fact pose any challenges in the way IKEA ought to compete across the globe? Why or why not?

4. What can IKEA do to continue to drive growth globally, especially given its strategic intent to double annual store openings?

5. Assume you are hired to consult IKEA on the topic of *corporate social responsibility* (see the discussion in Chapter 2). Which areas would you recommend the company be most sensitive to, and how should these be addressed?

TAKE-AWAY CONCEPTS

This chapter discussed the roles of MNEs for economic growth; the stages of globalization; why, where, and how companies go global; four strategies MNEs use to navigate between cost reductions and local responsiveness; and national competitive advantage, as summarized by the following learning objectives and related take-away concepts.

LO 10-1 / Define *globalization, multinational enterprise (MNE), foreign direct investment (FDI),* and *global strategy.*

- Globalization involves closer integration and exchange between different countries and peoples worldwide, made possible by factors such as falling trade and investment barriers, advances in telecommunications, and reductions in transportation costs.
- A multinational enterprise (MNE) deploys resources and capabilities to procure, produce, and distribute goods and services in at least two countries.
- Many MNEs are more than 50 percent globalized; they receive the majority of their revenues from countries other than their home country.
- Product, service, and capital markets are more globalized than labor markets. The level of everyday activities is roughly 10 to 25 percent integrated, and thus *semi-globalized.*
- Foreign direct investment (FDI) denotes a firm's investments in value chain activities abroad.

LO 10-2 / Explain why companies compete abroad, and evaluate the advantages and disadvantages of going global.

- Firms expand beyond their domestic borders if they can increase their economic value creation ($V - C$) and enhance competitive advantage.
- Advantages to competing internationally include gaining access to a larger market, gaining access to low-cost input factors, and developing new competencies.
- Disadvantages to competing internationally include the liability of foreignness, the possible loss of reputation, and the possible loss of intellectual capital.

LO 10-3 / Apply the CAGE distance framework to guide MNE decisions on which countries to enter.

- Most of the costs and risks involved in expanding beyond the domestic market are created by *distance.*
- The CAGE distance framework determines the *relative* distance between home and foreign target country along four dimensions: cultural distance, administrative and political distance, geographic distance, and economic distance.

LO 10-4 / Compare and contrast the different options MNEs have to enter foreign markets.

- The strategist has the following foreign-entry modes available: exporting, strategic alliances (licensing for products, franchising for services), joint venture, and subsidiary (acquisition or greenfield).
- Higher levels of control, and thus a greater protection of IP and a lower likelihood of any loss in reputation, go along with more investment-intensive foreign-entry modes such as acquisitions or greenfield plants.

LO 10-5 / Apply the integration-responsiveness framework to evaluate the four different strategies MNEs can pursue when competing globally.

- To navigate between the competing pressures of cost reductions and local responsiveness, MNEs have four strategy options: international, multidomestic, global-standardization, and transnational.
- An international strategy leverages home-based core competencies into foreign markets, primarily through exports. It is useful when the MNE faces low pressures for both local responsiveness and cost reductions.
- A multidomestic strategy attempts to maximize local responsiveness in the face of low pressure for cost reductions. It is costly and inefficient because it requires the duplication of key business functions in multiple countries.
- A global-standardization strategy seeks to reap economies of scale and location by pursuing a global division of labor based on wherever best-of-class capabilities reside at the lowest cost. It involves little or no local responsiveness.
- A transnational strategy attempts to combine the high local responsiveness of a localization strategy with the lowest-cost position attainable from a global-standardization strategy. It also aims to benefit from global learning. Although appealing, it is difficult to implement due to the organizational complexities involved.

LO 10-6 / Apply Porter's diamond framework to explain why certain industries are more competitive in specific nations than in others.

- National competitive advantage, or world leadership in specific industries, is created rather than inherited.
- Four interrelated factors explain national competitive advantage: (1) factor conditions, (2) demand conditions, (3) competitive intensity in a focal industry, and (4) related and supporting industries/complementors.
- Even in a more globalized world, the basis for competitive advantage is often local.

KEY TERMS

CAGE distance framework *(p. 353)*
Cultural distance *(p. 355)*
Death-of-distance hypothesis *(p. 362)*
Foreign direct investment (FDI) *(p. 342)*
Global-standardization strategy *(p. 360)*
Global strategy *(p. 342)*
Globalization *(p. 342)*
Globalization hypothesis *(p. 358)*
Integration-responsiveness framework *(p. 358)*
International strategy *(p. 359)*
Liability of foreignness *(p. 350)*
Local responsiveness *(p. 358)*
Location economies *(p. 349)*
Multidomestic strategy *(p. 360)*
Multinational enterprise (MNE) *(p. 342)*
National competitive advantage *(p. 363)*
National culture *(p. 354)*
Transnational strategy *(p. 361)*

DISCUSSION QUESTIONS

1. Multinational enterprises (MNEs) have an impact far beyond their firm boundaries. Assume you are working for a small firm that supplies a product or service to an MNE. How might your relationship change as the MNE moves from Globalization 2.0 to Globalization 3.0 operations?
2. Professor Pankaj Ghemawat delivered a TED talk titled "Actually, the World Isn't Flat." Do you agree with his assessment that the world is at most *semi-globalized,* and that we need to be careful not to fall victim to "globalony"? View the talk at: www.ted.com/talks/pankaj_ghemawat_actually_the_world_isn_t_flat?language=en.
3. The chapter notes that global strategy can change over time for a firm. MTV is highlighted as one example in Exhibit 10.8. Conduct a web search of a firm you know to be operating internationally and determine its current global strategy position. How long has the firm stayed with this approach? Can you find evidence it had a different global strategy earlier?

ETHICAL/SOCIAL ISSUES

1. A race to the bottom may set in as MNEs search for ever-lower-cost locations. Discuss the tradeoffs between the positive effects of raising the standard of living in some of the world's poorest countries with the drawbacks of moving jobs established in one country to another. Does your perspective change in light of several accidents in textile factories in Bangladesh, Cambodia, and elsewhere, where the cumulative death was over 1,000 workers? What responsibilities do MNEs have?
2. Will the Globalization 3.0 strategy persist through the 21st century? If not, what will Globalization 4.0 look like? Several American companies such as Apple and GE have realized that they miscalculated the full cost of managing far-flung production operations and are bringing production back to the United States. *Forbes* magazine put the blame on managers who were focused on maximizing shareholder value rather than emphasizing the long-term future of the firm.[84] That is, some managers looked only at labor costs and ignored the hidden costs of time and money trying to communicate quality and design concerns to workers across countries as well as unexpected costs to the supply chain from natural disasters or political threats. These factors combined with the new economics of energy (e.g., growing supply of natural gas) and new technologies (robotics, artificial intelligence, 3-D printing, and nanotechnology) are rapidly changing manufacturing and management decisions.

   Discuss the factors that managers of Apple or GE may consider as they focus on continuous innovation rather than the cost of manufacturing. How might governments with an interest in generating employment opportunities try to influence the decisions of firms? What other stakeholders may have an interest in bringing jobs back onshore and thus try to influence the decisions of firms? Consider the persuasive arguments and deals that might be struck. With changes to the location of production, what might Globalization 4.0 look like?

SMALL GROUP EXERCISES

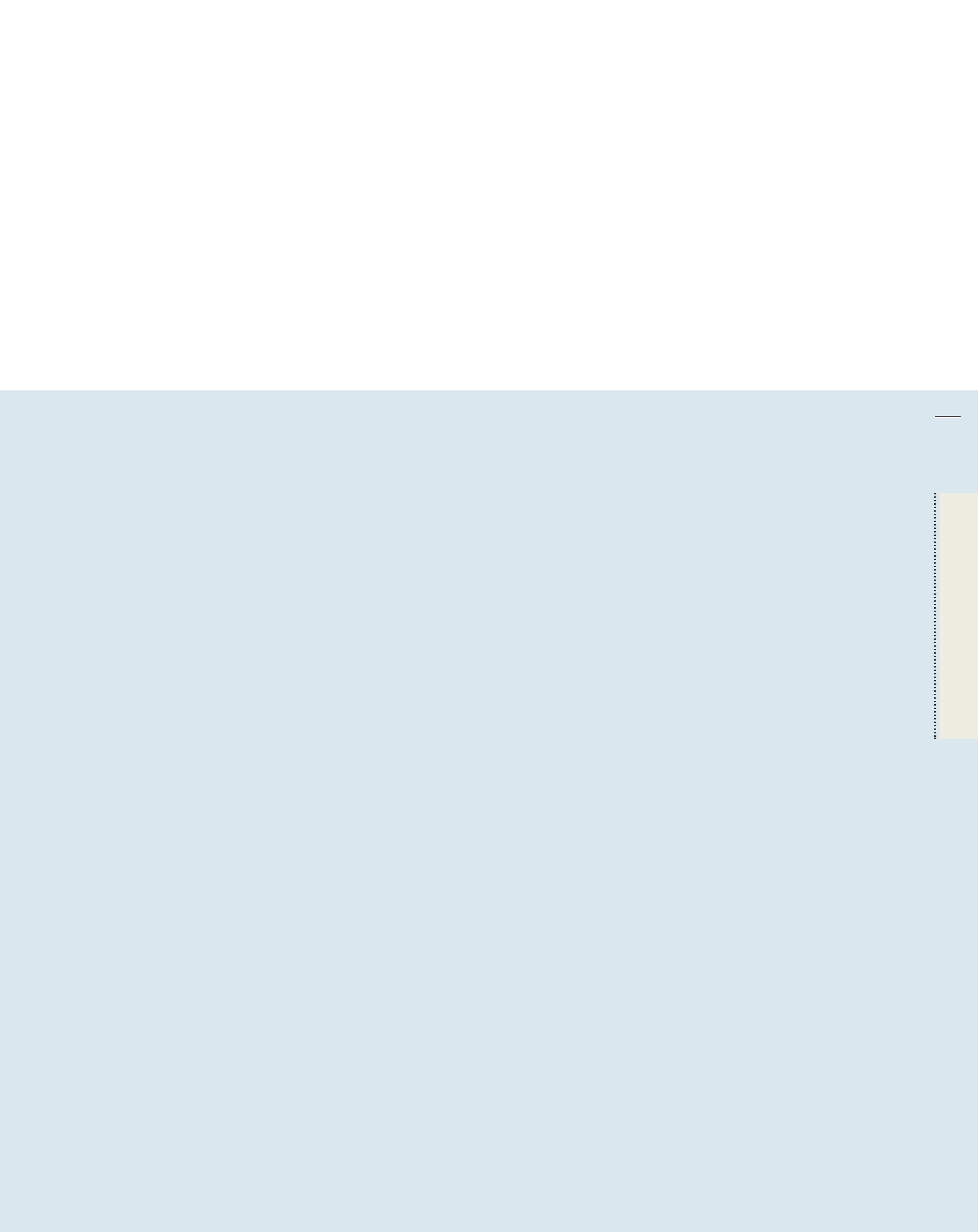
//// SMALL GROUP EXERCISE 1

Many U.S. companies have become global players. The technology giant IBM employs over 375,000 people and has revenues of roughly $95 billion. Although IBM is headquartered in Armonk, New York, the vast majority of its employees (more than 70 percent) actually work outside the United States. IBM, like many other U.S.-based multinationals, now earns the majority of its revenues (roughly two-thirds) outside the United States.[85] Though IBM revenues have been dropping in recent quarters, its global business is still a major focus for the firm.

1. Given that traditional U.S. firms such as IBM have over 70 percent of their employees outside the United States and earn almost two-thirds of their revenues from outside the country, what is an appropriate definition of a "U.S. firm"?
2. Should IKEA be considered a Swedish firm with less than 6 percent of sales garnered from the Swedish market? Discuss why or why not in your groups.
3. Is there any special consideration a firm should have for its "home country"? Is it ethical to keep profits outside the home country in offshore accounts to avoid paying domestic corporate taxes?

//// SMALL GROUP EXERCISE 2

In this exercise, we want to apply the four types of global strategy. Imagine your group works for Clif Bar (www.clifbar.com). Founded in 1992, the firm makes nutritious, all-natural food and drinks for sport and healthy snacking. Clif Bar is a privately held



ENDNOTES

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6. CAGE is an acronym for *c*ultural, *a*dministrative and political, *g*eographic, and *e*conomic distance. The model was introduced by Ghemawat, P. (2001, Sept.), "Distance still matters: The hard reality of global expansion," *Harvard Business Review*.

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10. We define *global strategy* as a "strategy of firms around the globe—essentially various firms' theories about how to compete successfully." This definition expands on a narrower alternative use of the term *global strategy,* which implies a global cost-leadership strategy in standardized products. This narrower approach we denote as *global-standardization strategy.* In both of these definitions we follow the work of M.W. Peng; see: Peng, M. (2013), *Global Strategy,* 3rd ed. (Mason, OH: South-Western Cengage) and elsewhere.

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54. The *power-distance dimension* of national culture focuses on how a society deals with inequality among people in terms of physical and intellectual capabilities and how those methods translate into power distributions within organizations. High power-distance cultures, like the Philippines (94/100, with 100 = high), tend to allow inequalities among people to translate into inequalities in opportunity, power, status, and wealth. Low power-distance cultures, like Austria (11/100), on the other hand, tend to intervene to create a more equal distribution among people within organizations and society at large.

The *individualism dimension* of national culture focuses on the relationship between individuals in a society, particularly in regard to the relationship between individual and collective pursuits. In highly individualistic cultures, like the United States (91/100), individual freedom and achievements are highly valued. As a result, individuals are only tied loosely to one another within society. In less-individualistic cultures, like Venezuela (12/100), the collective good is emphasized over the individual, and members of society are strongly tied to one another throughout their lifetimes by virtue of birth into groups like extended families.

The *masculinity–femininity dimension* of national culture focuses on the relationship between genders and its relation to an individual's role at work and in society. In more "masculine" cultures, like Japan (95/100),

gender roles tend to be clearly defined and sharply differentiated. In "masculine" cultures, values like competitiveness, assertiveness, and exercise of power are considered cultural ideals, and men are expected to behave accordingly. In more "feminine" cultures, like Sweden (5/100), values like cooperation, humility, and harmony are guiding cultural principles. The masculinity–femininity dimension uncovered in Hofstede's research is undoubtedly evolving over time, and values and behaviors are converging to some extent.

The *uncertainty-avoidance dimension* of national culture focuses on societal differences in tolerance toward ambiguity and uncertainty. In particular, it highlights the extent to which members of a certain culture feel anxious when faced with uncertain or unknown situations. Members of high uncertainty-avoidance cultures, like Russia (95/100), value clear rules and regulations as well as clearly structured career patterns, lifetime employment, and retirement benefits. Members of low uncertainty-avoidance cultures, like Singapore (8/100), have greater tolerance toward ambiguity and thus exhibit less emotional resistance to change and a greater willingness to take risks.

55. See: http://geert-hofstede.com/nationalculture.html. The available data, however, on the new dimensions are not, at this point, as comprehensive as for the four original dimensions. Alternatively, see the GLOBE cultural dimensions at www.grovewell.com/pub-GLOBE-intro.html.

56. This is based on: Kogut, B., and H. Singh (1988), "The effect of national culture on the choice of entry mode," *Journal of International Business Studies* 19: 411–432; Rothaermel, F.T., S. Kotha, and H. K. Steensma (2006), "International market entry by U.S. internet firms: An empirical analysis of country risk, national culture, and market size," *Journal of Management 32:* 56–82. Cultural distance from the United States, for example, is calculated as follows:

$$CD_j = \sum_{i=1}^{4} \left\{ (I_{ij} - I_{iu})^2 / V_i \right\} / 4$$

where I_{ij} stands for the index for the *i*th cultural dimension and *j*th country, V_i is the variance of the index of *i*th dimension, *u* indicates the United States, and CD_j is the cultural distance difference of the *j*th country from the United States.

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