Strategy in the Global Environment

OUTLINE

- Familiarize students with the importance of global competition and global competitors.
- Describe the benefits that global firms enjoy and also the costs they must bear.
- Discuss the pressures for cost reductions and local responsiveness that face global companies.
- Discuss the pros and cons of four different strategies for competing in the global marketplace: a global standardization strategy, a localization strategy, a transnational strategy, and an international strategy.
- Understand how global companies make decisions about which markets to enter, when to enter, and on what scale to enter.
- Discuss the advantages and disadvantages of various modes of entry into foreign markets.
- Identify the factors that determine which way of entering a foreign market is best for a particular company.

- Review the benefits and potential pitfalls of building global strategic alliances with competitors, and discuss ways of improving the probability of success for global strategic alliances.

I. Overview
   A. This reading opens with a discussion of the global competitive environment and them moves to considering the contribution of global strategy to the process of building and maintaining a competitive advantage and to outlining and discussing global strategies.
   B. Also covered are the decisions managers make about when and how to enter a foreign market.
   C. **Multinational companies**, companies that do business in two or more countries, are also discussed, as are global strategic alliances.

II. Global and National Environments
   A. Falling barriers to international trade and investment have triggered many changes in the international marketplace.
      1. There has been a surge in the volume of international trade and the value of foreign direct investment.
      2. This in turn has lead to the globalization of production and globalization of markets.
         a. Globalization of production has increased as companies take advantage of lower barriers to international trade and investment to disperse parts of their production around the world.
         b. This allows them to take advantage of national differences in cost and quality of factors of production.
      3. At the same time consumers' tastes have been merging around the world, meaning that it is no longer useful to discuss national markets. Implications of this globalization are:
         a. Industry boundaries do not stop at national borders. Efficient foreign producers can threaten local competitors.

b. Industry competition intensifies as national markets become parts of global markets.
c. Globalization has also created opportunities for companies to grow outside of their national markets.

B. National Competitive Advantage
1. There are still nation-based advantages that help determine the competitive position of a firm in some industries.
2. Four attributes of a nation- or country-specific environment that influences global competitiveness of local firms are described in **Michael Porter's Diamond** and include:
   a. Factor endowments: the nation's position in factors of production such as skilled labor or necessary infrastructure.
   b. Demand conditions: the nature of home demand for the industry's product or service.
   c. Relating and supporting industries: the presence or absence of supplier industries and related industries those are internationally competitive.
   d. Firm strategy, structure, and rivalry: the conditions of the home nation governing how companies are created, organized, and managed and the nature of domestic rivalry.

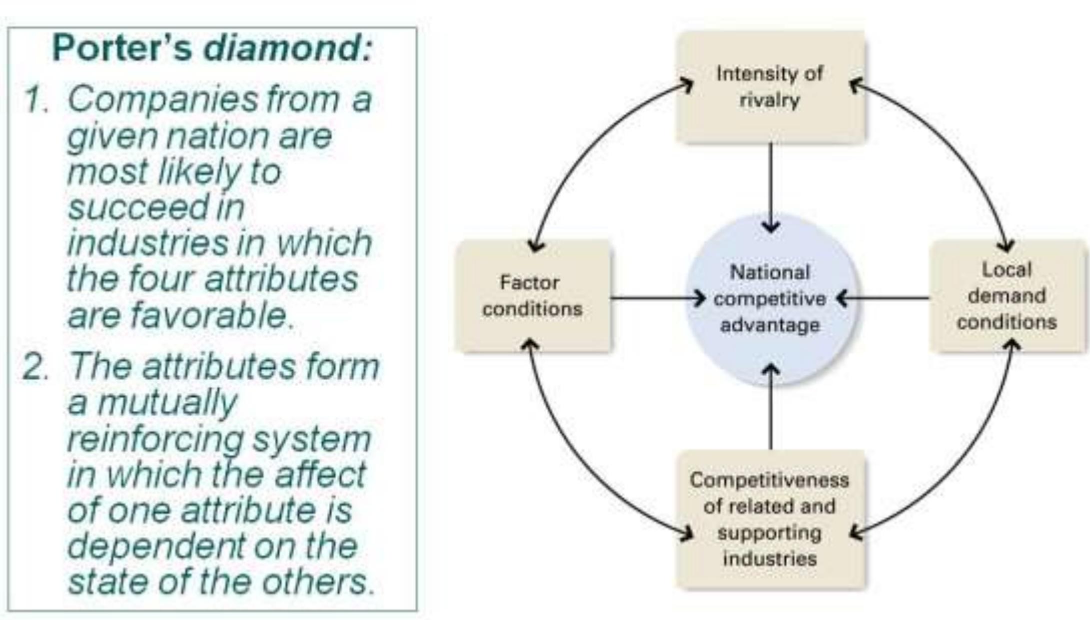

Figure 8.1: National Competitive Advantage

3. The framework can help mangers identify where their most significant global competitors are likely to come from. It can also help them decide where to locate specific activities. It can also be used to determine what obstacles might exist to entering specific countries.

Strategy in Action 8.1

Finland's Nokia

The wireless phone market is one of the great growth stories of the last decade. Starting from a very low base in 1990, annual global sales of wireless phones surged to reach 825 million units in 2005. By the end of 2005, there were over 1.7 billion wireless subscribers worldwide, up from less than 10 million in 1990. Nokia is one of the dominant players in the world market for mobile phones. Nokia's roots are in Finland, not normally a country that comes to mind when one talks about leading-edge technology companies. In the 1980s, Nokia was a rambling Finnish conglomerate with activities that embraced tire manufacturing, paper production, consumer electronics, and telecommunications equipment. By 2006, it had transformed itself into a focused telecommunications equipment manufacturer with a global reach, sales of over $40 billion, earnings of more than $5 billion, and a 34% share of the global market for wireless phones. How has this former conglomerate emerged to take a global leadership position in wireless telecommunications equipment? Much of the answer lies in the history, geography, and political economy of Finland and its Nordic neighbors.

In 1981, the Nordic nations cooperated to create the world's first international wireless telephone network. They had good reason to become pioneers: it cost far too much to lay down a traditional wire line telephone service in those sparsely populated and inhospitably cold countries. The same features made telecommunications all the more valuable: people driving through the Arctic winter and owners of remote northern houses needed a telephone to summon help if something went wrong. As a result, Sweden, Norway, and Finland became the first nations in the world to take wireless telecommunications seriously. They found, for example, that although it cost up to $800 per subscriber to bring a traditional wire line service to remote locations, the same locations could be linked by wireless cellular for only $500 per person. As a consequence, 12% of the people in Scandinavia owned cellular phones by 1994, compared with less than 6% in the United States, the world's second most developed market. This lead continued over the next decade. By the end of 2005, 90% of the population in Finland owned a wireless phone, compared with 70% in the United States.

Nokia, a long-time telecommunications equipment supplier, was well positioned to take advantage of this development from the start, but there were other forces at work that helped Nokia develop its competitive edge. Unlike almost every other developed nation, Finland has never had a national telephone monopoly. Instead, the country's telephone services have long been provided by about fifty or so autonomous local telephone companies whose elected boards set prices by referendum (which naturally means low prices). This army of independent and cost-conscious telephone service providers prevented Nokia from taking anything for granted in its home country. With typical Finnish pragmatism, its customers were willing to buy from the lowest-cost supplier, whether that was Nokia, Ericsson, Motorola, or some other company. This situation contrasted sharply with that prevailing in most developed nations until the late 1980s and early 1990s, where domestic telephone monopolies typically purchased equipment from a dominant local supplier or made it themselves. Nokia responded to this competitive pressure by doing everything possible to drive down its manufacturing costs while staying at the leading edge of wireless technology.

The consequences of these forces are clear. Nokia is now a leader in digital wireless technology. Many now regard Finland as the lead market for wireless telephone services. If you want to see the future of wireless, you don't go to New York or San Francisco; you go to Helsinki, where Finns use their wireless handsets not just to talk to each other but also to browse the Web, execute e-commerce transactions, control household heating and lighting systems, or purchase Coke from a wireless-enabled vending machine. Nokia has gained this lead because Scandinavia started switching to digital technology five years before the rest of the world.[a]

III. Increasing Profitability and Profit Growth Through Global Expansion

A. Expanding globally lets both large and small companies increase their profitability in a number of ways not available to purely domestic enterprises.

1. Firms can market goods or services developed at home and sell them internationally. This is especially valuable if indigenous competitors lack comparable products. Additionally, the success of many multinational competitors is not based just upon their goods and services but on the distinctive competencies that underlie their production or marketing.
2. Firms can also realize cost savings from economies of scale through international expansion.
   a. They can spread fixed costs of development and production over a global market.

b. They can utilize capacity more intensively
c. The size gained through global expansion can lead to increased bargaining power, leading to lower costs.
d. There may also be learning effects associated with a global market.

B. Another way for firms to increase their profitability through internationalization is the realization of **location economies**, those benefits that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be.
   1. One benefit of location economies is the lowering of costs for raw materials, power, labor, and so on. This is consistent with the business-level strategy of cost leadership.
   2. Another benefit of location economies is the firm's improved ability to differentiate its product, consistent with a differentiation business-level strategy.
   3. However, a negative consequence of pursing location economies is the potential for increased transportation costs and unfavorable trade barriers.
   4. Another possible negative consequence is the increased political and economic risk in regions where governments are unstable or implementing unfavorable business policies.

C. Another benefit of global expansion is the ability of multinational firms to leverage the skills of global subsidiaries. Multinational firms with foreign subsidiaries can have valuable competencies arise in any of their locations, and then share that knowledge with other subsidiaries. This creates important new challenges for managers.
   1. Managers must recognize that competencies can develop anywhere and be on the lookout for those new competencies.
   2. The firm must have an incentive system for local subsidiaries to develop new competencies.
   3. Managers must be able to identify new competencies and help to transfer them within the company.

IV. Pressures for Cost Reductions and Local Responsiveness

A. Companies that compete in the global marketplace face competitive pressures for cost reductions and pressures to be locally responsive. These competitive pressures place conflicting demands on a company.
   1. Responding to pressures for cost reductions demands that a company try to minimize its unit costs. To accomplish this, a company must base its activities at the most favorable low-cost location, wherever in the world that might be. It must also offer a standardized product to the global marketplace in order to ride down the experience curve as quickly as possible.
   2. Reacting to pressures to be locally responsive requires a company to differentiate its product offering and marketing strategy from country to country. It must try to accommodate the diverse demands arising from national differences, which can lead to significant duplication and a lack of standardization, raising costs.

B. Pressures for cost reductions arise from several sources.
   1. Pressures for cost reductions are intense in industries producing commodity-type products that serve universal needs. For these products, differentiation on nonprice factors is difficult and price is the main competitive weapon.
   2. Pressures for cost reductions are also strong in industries where major competitors are based in low-cost locations, where there is persistent excess capacity, and

where consumers are powerful and face low switching costs.

3. Liberalization of the world trade and investment environment in recent decades has generally increased cost pressures by facilitating greater international competition.

Figure 8.2: Pressures for Cost Reductions and Local Responsiveness

C. Pressures for local responsiveness arise from several sources.
   1. One source of strong pressures for local responsiveness emerge when consumer tastes and preferences differ significantly between countries, for historic or cultural reasons. Products and marketing messages have to be customized for local tastes and preferences, leading to the delegation of production and marketing functions to national subsidiaries.
      a. However, some observers claim that consumer demands for local customization are on the decline worldwide because modern communications and transportation technologies have led to a convergence of tastes and preferences. The result is the emergence of enormous global markets for standardized consumer products.
      b. However, other commentators have observed that in some industries, consumers have reacted to an overdose of standardized global products by showing a renewed preference for products that are differentiated to local conditions.
   2. Another source of pressures for local responsiveness emerge when there are differences in infrastructure and traditional practices between countries, creating a need to customize the product. This may necessitate the delegation of manufacturing and production functions to foreign subsidiaries.
   3. Pressures for local responsiveness may arise when a company’s marketing strategies have to be responsive to differences in distribution channels between countries. This may necessitate the delegation of marketing functions to national subsidiaries.
   4. Economic and political demands imposed by host country governments may

require a degree of local responsiveness. Examples of threats from host governments include protectionism, economic nationalism, and regulations to ensure local content.

Strategy in Action 8.2

Localization at IKEA

IKEA may be the world's most successful global retailer. Established by Ingvar Kamprad in Sweden in 1943 when he was just seventeen years old, the home-furnishing superstore has grown into a global cult brand, with 230 stores in thirty-three countries that host 410 million shoppers a year and generated sales of €14.8 billion ($17.7 billion) in 2005. Kamprad himself, who still owns the private company, is rumored to be the world's richest man.

IKEA's target market is the global middle class who are looking for low-priced but attractively designed furniture and household items. The company applies the same basic formula worldwide: open, large warehouse stores, festooned in the blue and yellow colors of the Swedish flag, that offer 8,000 to 10,000 items, from kitchen cabinets to candlesticks. Use wacky promotions to drive traffic into the stores. Configure the interior of the stores so that customers have to pass through each department to get to the checkout. Add restaurants and child-care facilities so that shoppers stay as long as possible. Price the items as low as possible. Make sure that product design reflects the simple clean Swedish lines that have become IKEA's trademark. And then watch the results: customers who enter the store planning to buy a $40 coffee table and end up spending $500 on everything from storage units to kitchen ware.

IKEA aims to reduce the price of its offerings by 2 to 3% per year, which requires relentless attention to cost cutting. With a network of 1,300 suppliers in fifty-three countries, IKEA devotes considerable attention to finding the right manufacturer for each item. Consider the company's best-selling Klippan love seat. Designed in 1980, the Klippan, with its clean lines, bright colors, simple legs, and compact size, has sold some 1.5 million units since its introduction. Originally manufactured in Sweden, IKEA soon transferred production to lower-cost suppliers in Poland. As demand for the Klippan grew, IKEA then decided that it made more sense to work with suppliers in each of the company's big markets to avoid the costs associated with shipping the product all over the world. Today, there are five suppliers of the frames in Europe, plus three in the United States and two in China. To reduce the cost of the cotton slipcovers, production has been concentrated in four core suppliers in China and Europe. The resulting efficiencies from these global sourcing decisions enabled IKEA to reduce the price of the Klippan by some 40% between 1999 and 2005.

Despite its standard formula, however, IKEA has found that global success requires that it adapt its offerings to the tastes and preferences of consumers in different nations. IKEA first discovered this in the early 1990s, when it entered the United States. The company soon found that its European style offerings didn't always resonate with American consumers. Beds were measured in centimeters, not the king, queen, and twin sizes that Americans are familiar with. Sofas weren't big enough, wardrobe drawers were not deep enough, glasses were too small, curtains were too short, and kitchens didn't fit U.S. size appliances. Since then, IKEA has redesigned its offerings in the United States to appeal to American consumers, and it has been rewarded with stronger store sales. The same process is now unfolding in China, where the company plans to have ten stores by 2010. The store layout in China reflects the layout of many Chinese apartments, and since many Chinese apartments have balconies, IKEA's Chinese stores include a balcony section. IKEA has had to adapt its locations to China, where car ownership is still not widespread. In the West, IKEA stores are generally located in suburban areas and have lots of parking space, but in China they are located near public transportation, and IKEA offers delivery services so that Chinese customers can get their purchases home.[b]

V. Choosing a Global Strategy

A. Companies use four basic strategies to enter and compete in the international environment: (1) global standardization strategy, (2) localization strategy, (3) transnational strategy, and (4) international strategy. Each of these strategies has advantages and disadvantages. The appropriateness of each strategy varies with the extent of pressures for cost reductions and local responsiveness.

B. A firm must balance the pressures for cost reductions with the pressures for local responsiveness. In order to customize products to respond to local demands, the firm may have to give up some of the potential cost savings. Also, the firm may not be able to fully leverage its distinctive competencies.

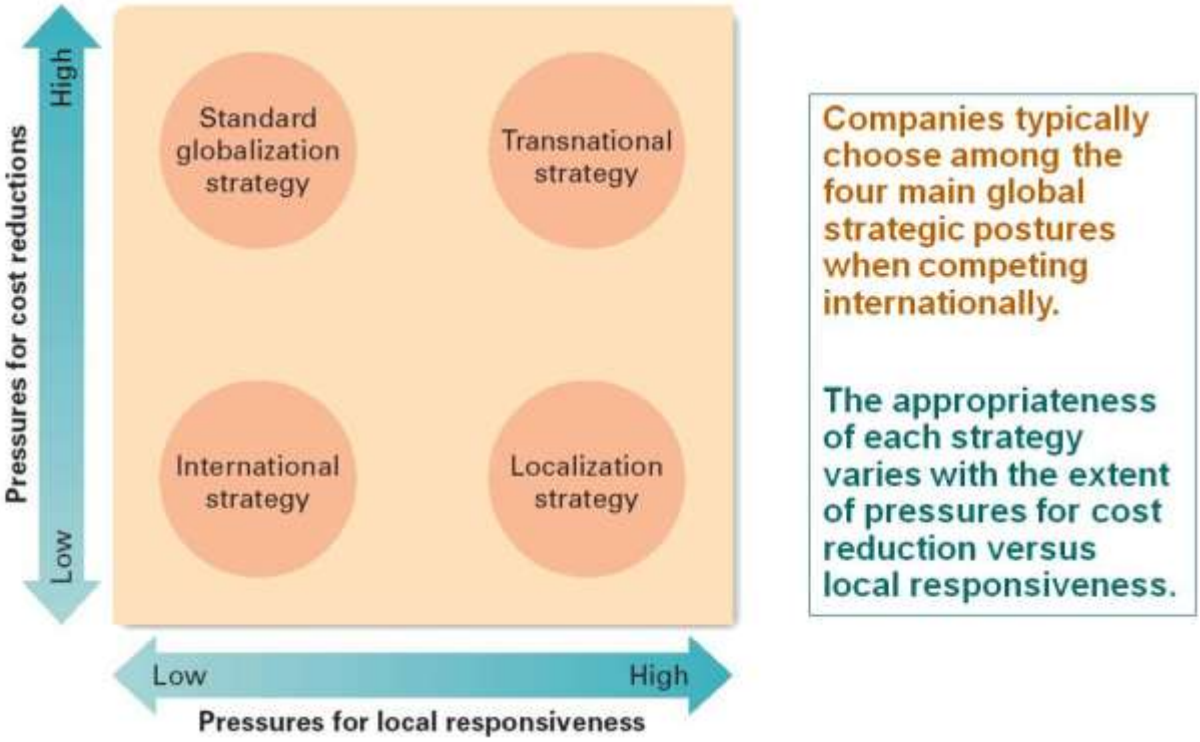

Figure 8.3: Four Basic Strategies

1. One global strategy is the **global standardization strategy**, which focuses on increasing profitability by reaping the cost reductions that come from experience-curve effects and location economies. Firms pursuing a global strategy are attempting to be cost leaders.
    a. The production, marketing, and R&D activities of companies pursuing a global strategy are concentrated in a few favorable locations.

RUNNING CASE

Dell's Global Business Strategy

Dell has been expanding its presence outside the United States since the early 1990s. In fiscal 2006, 41% of Dell's $56 billion in revenue was generated outside the United States. Dell's strategic goal is to be the low-cost player in the global industry. It does not alter its business model from country to country; instead, it uses the same direct-selling and supply chain model that worked so well in the United States. Dell is thus pursuing a global standardization strategy.

Dell's basic approach to overseas expansion has been to serve foreign markets from a handful of regional manufacturing facilities, each established as a wholly owned subsidiary. To support its global business, it operates three final assembly facilities in the United States, one in Brazil (serving South America), two in Ireland (serving Europe), one in Malaysia (serving Southeast Asia), and two in China (serving China). Each of these plants is large enough to attain significant economies of scale. When demand in a region gets large enough, Dell considers opening a second plant; thus, it has three plants in the United States to serve North America, and two in Ireland to serve Europe. With sales growing rapidly in India, the company will bring an Indian plant online in 2007.

Each plant uses exactly the same supply chain management processes that have made Dell famous. Taking advantage of its supply chain management software, Dell schedules production of every line in every factory around the world every two hours. Every factory is run with no more than a few hours of inventory on hand, including work in progress. To serve Dell's global factories, many of Dell's largest suppliers have also located their facilities close to Dell's manufacturing plants so that they can better meet the company's demands for just-in-time inventory.

Dell has set up customer service centers in each region to handle phone and online orders and to provide technical assistance. In general, each center serves an entire region, which Dell has found to be more efficient than locating a customer service center in each country where the company does business. Beginning in 2001, Dell started to experiment with outsourcing some of its customer service functions for English-language customers to call centers in India. Although the move helped the company to lower costs, it also led to dissatisfaction from customers, particularly in the United States, who could not always follow the directions given over the phone from someone with an Indian accent. Subsequently, Dell moved its call centers for English-language businesses back to the United States and the United Kingdom. Dell continues to invest in Indian call centers for its retail customers, however, and in 2006, it announced that it was opening a fourth Indian call center.[c]

  b. Global companies do not customize their products and marketing strategy to local conditions because customization raises costs. Instead, global companies market a standardized product worldwide so that they can reap the maximum benefits from the economies of scale that underlie the experience curve.
  c. Global companies use their cost advantage to support aggressive pricing.
  d. A global strategy makes most sense when there are strong pressures for cost reductions, but minimal demands for local responsiveness. These conditions prevail in many industrial goods industries, but are not as common in consumer goods.

2. Another global strategy is the **localization strategy**, in which a firm orients itself toward achieving maximum local responsiveness.
  a. Localization companies transfer skills and products developed at home to foreign markets; however, unlike international companies, they extensively customize both their product offering and their marketing strategy.
  b. Localized firms also establish a complete set of value creation activities in each major national market in which they do business. Localized companies are unable to realize value from experience-curve effects and location economies, and therefore have a high cost structure and are unable to leverage distinctive competencies.
  c. A localization strategy makes sense when there are strong pressures for local responsiveness and weak pressures for cost reductions.

d. Another drawback of this strategy is that many localized companies develop into decentralized federations in which each national subsidiary functions in a largely autonomous manner. They typically lack the ability to transfer local distinctive competencies to their worldwide subsidiaries.

3. Increasingly, companies must be both low-cost and differentiated in order to compete, especially in the intense rivalry found in industries with many multinational competitors. A **transnational strategy** allows companies to pursue both goals simultaneously.
   a. A transnational strategy allows skills and products to flow in both directions between the home country and the foreign subsidiaries in a process referred to as global learning.
   b. The transnational strategy makes sense when a company faces high pressures for cost reductions and high pressures for local responsiveness. However, this strategy is not an easy one to pursue because pressures for local responsiveness and cost reductions place conflicting demands on a company.
   c. To deal with cost pressures, companies can redesign their products to use identical components. Another tactic is to invest in a few large-scale manufacturing facilities sited at favorable locations and then augment those with assembly plants in each of its major markets, which allows for tailoring the finished product to local needs.
4. Another global strategy is the **international strategy**, in which a firm tries to create value by transferring valuable skills and products to foreign markets where indigenous competitors lack those skills and products.
   a. International companies create value by transferring differentiated product offerings developed at home to new markets overseas. They centralize product development functions at home.
   b. However, international companies also establish manufacturing and marketing functions in each major country. They undertake limited local customization of products and marketing strategy, but the head office retains tight control over these.
   c. An international strategy can be very profitable if a company has a valuable distinctive competency that indigenous competitors lack and if the pressures for local responsiveness and cost reductions are relatively weak.
   d. However, when pressures for local responsiveness are strong, companies pursuing this strategy lose out to companies that customize products for local conditions. Moreover, because they must duplicate manufacturing facilities, international companies suffer from high operating costs.
5. Although a transnational strategy appears to offer the most advantages, it should not be forgotten that implementing it raises difficult organizational issues. The appropriateness of each strategy depends on the relative strength of pressures for cost reductions and pressures for local responsiveness.

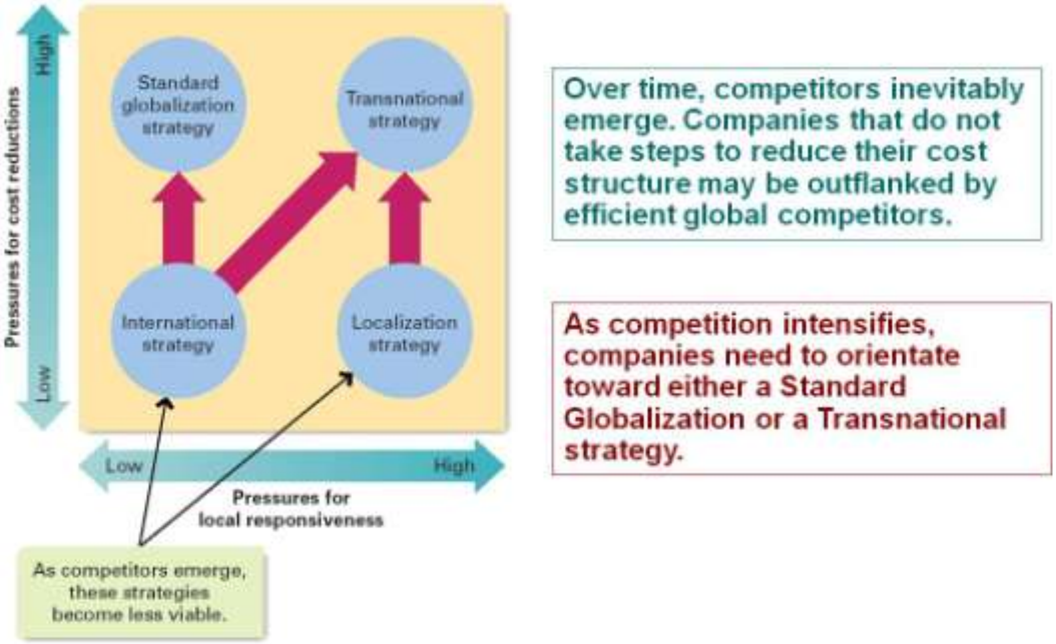

Figure 8.4: Changes over Time

C. A firm contemplating expansion into foreign markets must confront decisions about which markets to enter, when to enter, and on what scale to enter.
   1. The choice among different foreign markets must be made on the basis of an assessment of their long-run profit potential, balancing the benefits, costs, and risks associated with doing business in that country.
      a. The long-run economic benefits of doing business in a country are a function of factors such as the number of buyers in a market, the purchasing power of buyers, and their likely future purchasing power.
      b. The benefit-cost risk calculation is complicated by the fact that the potential long-run benefits bear little relationship to a nation's current stage of economic development or political stability. Rather, they depend on likely future economic growth rates, which are a function of a free market system and a country's capacity for growth, which may be greater in less-developed nations.
      c. One other factor is the value that international business can create in a foreign market through offering a product that has been unavailable and that satisfies an unmet need.
   2. With regard to the timing of entry, we say that entry is early when an international business enters a foreign market before other foreign firms, and late when it enters after other international businesses have already established themselves.
      a. Several first-mover advantages are frequently associated with entering a market early.
         (i) One advantage is the ability to preempt rivals and capture demand by establishing a strong brand name.
         (ii) A second advantage is the ability to build up sales volume, revenue, and market share in that country and ride down the experience curve ahead of rivals.
         (iii)A third advantage is the ability of early entrants to create switching costs that tie customers into their products or services.

      b. There can also be disadvantages associated with entering a foreign market before other international businesses.

(i) One disadvantage is **pioneering costs,** or costs that an early entrant has to bear but a later entrant can avoid.

(ii) Pioneering costs arise when the business system in a foreign country is very different than in a firm's home market.

(iii) Pioneering costs also arise when the company makes strategic mistakes through ignorance.

(iv) Another source of pioneering costs is the cost of educating customers about products with which they may be unfamiliar.

(v) Research shows evidence that the early mover advantages are outweighed by the disadvantages, in most cases. Therefore, it pays for companies to be late entrants into new foreign markets.

3. An international business also needs to decide on the scale of its entry into a foreign market.
   a. Entering a market on a large scale involves the commitment of significant resources to that venture. Smaller companies may not have the resources necessary to enter on a large scale. Even some large enterprises prefer to enter foreign markets on a small scale and then build their presence slowly over time as they become familiar with the foreign market in order to reduce risk.
   b. A **strategic commitment** is a decision that has a long-term impact and is difficult to reverse. Deciding to enter a foreign market on a significant scale is a major strategic commitment.

      (i) Strategic commitments, such as large-scale market entry, can have an important influence on the nature of competition in a market through signaling to competitors.

      (ii) Large companies are more likely to have the resources necessary to successfully implement a strategic commitment to early entry than are small companies.

      (iii) Small-scale entry is a way of gathering more information about a foreign market before making a large-scale strategic commitment, and therefore can reduce risk and increase the chances of entry success, although delay will also cause the company to lose any first-mover advantages.

VI. The Choice of Entry Mode

A. Most manufacturing companies begin their global expansion as exporters, making their products in the home country and then transporting them to foreign markets for sale.

1. **Exporting** avoids the costs of having to establish manufacturing operations in the host country, and it is consistent with a pure global strategy.
2. However, exporting from the company's home base may not be appropriate if there are lower-cost locations for manufacturing the product abroad. High transport costs or tariff barriers can make exporting uneconomical.
3. Also, many exporters rely on local sales agents, and it is difficult for the company to ensure that the agents act in the company's best interests. Some exporters establish wholly owned market subsidiaries in the host country to eliminate this concern.

B. Companies that lack capital to develop operations overseas or that are unwilling to make a significant investment in a risky country choose **licensing** as their entry mode. Like exporting, licensing is a fairly low-risk strategy. Licensing involves a company selling the rights to certain intangibles, such as product design or brand name, to foreign licensees in return for royalty payments.

1. The advantage of licensing is that the company does not have to bear the development costs and risks associated with opening up a foreign market.
2. A drawback of licensing is the lack of tight control over manufacturing, marketing, and strategic functions, which can hinder the firm's ability to realize experience curve and location economies.
3. Competing in a global marketplace may require a company to coordinate strategic moves across countries so that the profits earned in one country can be used to support competitive attacks in another. Licensing severely limits a company's ability to do so.
4. By licensing its technology, a company often gives away valuable know-how to future competitors. To limit this risk, some companies use a **cross-licensing agreement**. This agreement asks the foreign licensee to license some of its valuable technology to the licensor in addition to royalty payments.

C. **Franchising** occurs when a company sells limited rights to franchisees to use its brand name in return for a lump sum payment and a share of the franchisee's profits. Franchising involves the sale of intangible assets, but also typically imposes strict rules on the franchisee. Franchising is often for a longer period of time than is licensing. Licensing is common among manufacturing companies, whereas franchising is used primarily by service companies.

1. The advantages of franchising as an entry mode are the same as those of licensing. The franchiser doesn't bear the development costs and risks. Therefore, a global presence can be built quickly and inexpensively.
2. The disadvantages of franchising are somewhat less than those of licensing. One disadvantage is that franchising may inhibit global strategic coordination.
3. Another disadvantage is that foreign franchisees may not be as concerned about quality as the franchiser is, and poor quality may mean not only lost sales, but also a decline in the company's worldwide reputation. To alleviate this concern, some companies set up subsidiaries in each country, which then oversee the franchisees to ensure that quality is maintained.

D. **Joint ventures** require a sharing of ownership, along with the sharing of all attendant costs and benefits, between a company in the home country and one in the host country. To maintain control, some multinational firms maintain a majority share of ownership.

1. Joint ventures have the advantage that a multinational can benefit from a local partner's knowledge of a host country's competitive conditions, culture, language, political systems, and business systems.
2. Another advantage is the sharing of costs and risk of setting up business with a local partner.
3. A third advantage is that, in many countries, political considerations make joint ventures the only feasible entry mode.
4. One drawback of joint ventures is the risk of losing control over technology. Some companies cope with this threat by not allowing foreign partners to own a majority stake in the venture. However, some foreign partners may not be willing to accept minority ownership.
5. Another drawback exists because a joint venture does not give a company tight control over different subsidiaries that it needs to realize economies or engage in

coordinated global attacks against global rivals.

E. A **wholly owned subsidiary** is created when the parent company owns 100 % of its subsidiary's stock. A company can establish a wholly owned subsidiary either by acquisition or by setting up a completely new operation.
   1. One advantage of a wholly owned subsidiary is the tight control the company maintains over its distinctive competencies, which can be especially important when the competitive advantage is based on control over a technological competency.
   2. Another advantage is that a wholly owned subsidiary gives a company the kind of tight control over operations in different countries that is necessary for pursuing a global strategy—supporting competitive attacks in one country with profits from another.
   3. A wholly owned subsidiary allows the company to realize location and experience curve economies.
   4. However, a wholly owned subsidiary is the most costly method of serving a foreign market, and companies taking this approach bear the full costs and risks associated with setting up overseas operations.
   5. These costs and risks can be diminished somewhat by using acquisition, rather than setting up a new operation. However, acquisitions raise a host of additional problems, such as trying to integrate two disparate operations and cultures. Acquisitions and the problems associated with them are discussed in more detail in Reading 10.

F. Inevitably, choosing an entry mode involves tradeoffs. Therefore, it is difficult to make specific recommendations as to what a company should do. A number of rough generalizations can be made, however.
   1. One area that companies must consider when choosing a mode of entry into international markets is the source of their competitive advantage.
      a. If a company's competitive advantage is based on control of proprietary technological know-how, wholly owned subsidiary is the best strategy to minimize the risk of losing control over that technology. Other entry modes might work also, if measures are taken to reduce the risks.
      b. If the company is using technological know-how, but the technological advantage is expected to be short-lived anyway, then a licensing strategy might be more appropriate because it allows rapid diffusion of the technology. Rapid diffusion raises royalty payments, and makes it more likely that the company's technology will be accepted as the dominant design.
      c. The competitive advantage of many service companies is based on management know-how, where the risk of losing control is not high. The valuable asset of such companies is their brand name, which is protected by international trademark laws. Such companies should use franchising and wholly owned or joint venture subsidiaries to control the franchisees. Some companies prefer a joint venture because it is more politically acceptable and brings a degree of local knowledge.
   2. A second area for consideration in choosing an entry mode is the level of pressures for cost reduction.
      a. The greater the pressures for cost reductions, the more a company should pursue some combination of exporting and wholly owned subsidiaries. By manufacturing in those locations where factor conditions are optimal and then exporting to the rest of the world, a company may be able to realize substantial location economies and experience-curve effects.

b. Wholly owned subsidiaries are preferable to joint ventures because they give the company tighter control over marketing, increasing coordination and allowing the profits generated in one market to be used to improve competitive position in another.

VII. Global Strategic Alliances

A. **Global strategic alliances** are cooperative agreements between companies from different countries that are actual or potential competitors. Strategic alliances vary considerably in the length of time and degree of interrelatedness they offer.

B. Companies enter into strategic alliances with actual or potential competitors in order to achieve certain strategic objectives.

1. Strategic alliances may facilitate entry into a foreign market.
2. Strategic alliances allow companies to share the fixed costs and associated risks that arise from the development of new products or processes.
3. Alliances bring together complementary skills and assets that neither company could easily develop on its own.
4. Alliances help companies set technological standards for their industry, which can benefit the allied firms.

C. One problem with global strategic alliances is that they can give a firm's competitors a low-cost route to gaining new technology and market access. Unless it is careful, a company can give away more than it gets in return.

Strategy in Action 8.3

Cisco and Fujitsu

In late 2004, Cisco Systems, the world's largest manufacturer of Internet routers, entered into an alliance with the Japanese computer, electronics, and telecommunications equipment firm, Fujitsu. The stated purpose of the alliance was to jointly develop next-generation high-end routers for sale in Japan. Routers are the digital switches that sit at the heart of the Internet and direct traffic—they are, in effect, the traffic cops of the Internet. Although Cisco has long held the leading share in the market for routers (indeed, it pioneered the original router technology), it faces increasing competition from other firms such as Juniper Technologies and China's fast growing Huawei Technologies. At the same time, demand in the market is shifting as more and more telecommunications companies adopt Internet-based telecommunications services. While Cisco has long had a strong global presence, management also felt that the company needed to have a better presence in Japan, which is shifting rapidly to second-generation high-speed Internet-based telecommunications networks.

By entering into an alliance with Fujitsu, Cisco feels it can achieve a number of goals. First, both firms can pool their R&D efforts, which will enable them to share complementary technology and develop products quicker, thereby gaining an advantage over competitors. Second, by combining Cisco's proprietary leading-edge router technology with Fujitsu's production expertise, the companies believe that they can produce products that are more reliable than those currently offered. Third, Fujitsu will give Cisco a stronger sales presence in Japan. Fujitsu has good links with Japan's telecommunications companies and a well-earned reputation for reliability. It will leverage these assets to sell the routers produced by the alliance, which will be co-branded as Fujitsu-Cisco products. Fourth, sales may be further enhanced by bundling the co-branded routers together with other telecommunications equipment that Fujitsu sells and marketing an entire solution to customers. Fujitsu sells many telecommunications products, but it lacks a strong presence in routers. Cisco is strong in routers but lacks strong offerings elsewhere. The combination of the two company's products will enable Fujitsu to offer Japan's telecommunications companies end-to-end communications solutions. Since many companies prefer to purchase their equipment from a single provider, this should drive sales.

The alliance introduced its first products in May 2006. If it is successful, both firms should benefit. Development costs will be lower than if they did not cooperate. Cisco will grow its sales in Japan, and Fujitsu can use the co-branded routers to fill out its product line and sell more bundles of products to Japan's telecommunications companies.[d]

VIII. Making Strategic Alliances Work

A. The failure rate of global strategic alliances is quite high—two-thirds have some initial problems, and one-third are eventually rated as failures.

B. The benefits a company derives from a strategic alliance seem to be a function of several factors.
   1. One of the keys to making a strategic alliance work is to select the right kind of partner.
      a. The partner must be able to help the company achieve its strategic goals through the possession of capabilities that the company lacks but values.
      b. The partner must share the company's vision for the purpose of the alliance.
      c. The partner must be unlikely to try to opportunistically exploit the alliance for its own ends, expropriating the company's technological know-how while giving little in return.
      d. d) Therefore, companies must thoroughly research potential alliance partners.
   2. Another critical factor in alliance success is a structure that reduces the risks of a company giving too much away to its alliance partner without getting anything in return.
      a. Alliances can be designed to make it difficult to transfer technology that is not meant to be transferred. Specifically, the product or process may be structured so as to "wall off" the most sensitive technologies and prevent their leakage to others.
      b. Contractual safeguards can be written into an alliance agreement to diminish the risk of opportunism by a partner.
      c. Both parties can agree in advance to exchange skills and technologies that the other wants, thereby ensuring an equitable gain. Cross-licensing agreements are one way of achieving this goal.
      d. The risk of opportunism can be decreased if the company extracts a significant credible commitment in advance, requiring each partner to make such a substantial and long-term investment that the chances of opportunism are sharply reduced.

Figure 8.5: Structuring Alliances to Reduce Opportunism

   3. The last critical factor for success is to manage the alliance in a way that maximizes benefits.
      a. One important management tactic is to develop sensitivity to cultural differences. Managers must take differences into account when dealing with their partner.
      b. Another contributor to managing an alliance successfully is building interpersonal relationships between managers from the different companies, which means building trust as well as an informal network to resolve issues.

c. Learning from the partner is a major factor in determining how much a company gains from an alliance. Firms that view the alliance as merely a cost- or risk-sharing device receive fewer benefits.
d. Therefore, an effective strategy would be to educate all employees about the partner's strengths and weaknesses, as well as inform them about the particular skills that the company hopes to learn from the partner. Then, the resultant learning must be spread in a coordinated fashion throughout the company.