

International Business Management

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Lecture 5

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تسعى لتكون الكيان الأول الذي يتبنى مبدأ المجتمع التعليمي
التعاوني، ويقدم العلم مقابل العمل لتنمية وبناء المجتمعات

MGM 506

International Environment and Strategy



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Learning Objectives

Planning definition

strategic planning process

strategic planning processes of a domestic company and an MNC

International Business Environment

Environmental factors

different approaches to host government relations

The Competition

Four MNC Strategies

Introduction

Samsung Electronics is one of the Korean companies that survived the market crisis in 1997. Nowadays, it is entering the top level of the world's technology companies, being the leader in wireless technologies with devices ranging from personal digital assistants to refrigerators. Today, Samsung is the world's largest producer of memory chips and flat-panel monitors. It also has built a strong position in the manufacture of DVDs and cell phones. The Samsung Group is the largest corporate entity in South Korea. It is the equivalent of what a combined IBM-Intel Citigroup-Caterpillar-Aetna would be in the United States. It manufactures globally, employs more than 308,745 people in 79 countries (as of 2016), and generates 70% of its revenues outside Korea

As a matter of fact, Sony is an important customer of Samsung—it buys semiconductors and displays from them.

Also, Samsung is a valued partner producing components for large US firms such as Dell Computer, Hewlett-Packard, IBM, and Microsoft.

It has a partnership with the Sprint Corporation. Through the application of a new strategy, Samsung achieved the goal of becoming Korea's first great global company.

Samsung ,to change its image in the world's largest market, the United States, it consolidated its 55 advertising agency accounts into one with a new, imaginative campaign of surreal advertisements.

Another way in which Samsung is creating its new image is by 6 International Environment such as Walmart, which emphasize price over quality, and moving into specialty stores such as Best Buy. It greatly improved its products' quality and designs, but it is planning to do more. It is aiming to double its sales in a few years and to become an innovation leader like Apple Computer or Sony Corporation. To promote itself as a global electronics company, it has opened up to foreign managers and appointed non-Koreans to its board. Also, foreigners own 60% of the company



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Planning:

is the process of establishing organizational goals and the determination of methods to attain these goals. Strategic planning is the alignment of organizational capabilities with the present and anticipated future environmental changes, in the pursuit of goal attainment. Because organizations are formed to satisfy societal needs and because their survival depends on securing the resources needed to achieve these goals, understanding and awareness of environmental forces are essential to the strategic planning process

Environmental forces are not constant;

they change over time. In the past, organizations faced fewer environmental changes, at a slower pace. Today, more changes are taking place at faster rates, and this trend is accelerating.

According to Harry Ansoff, known as the Father of Strategic Management the predecessor of strategic planning is long-range planning which is based on two premises.

First, environmental changes are assumed to be continuous.

Second, these changes are assumed to be predictable through extrapolation of the historical growth

the strategic planning process begins :

with a determination of the organizational mission and goals. After the establishment of the mission and goals, the process proceeds with two interdependent and simultaneous analyses:

internal assessment. The internal assessment provides information regarding the internal capabilities (strengths) and limitations (weaknesses) of the firms.

Environmental scanning enables the firm, domestic or international, to identify existing opportunities and threats in the environment.

Once the appropriateness of the organizational **mission and goals** is resolved, two sequential phases of **strategy formulation** and **implementation begin**. The formulation phase creates the plan for future activities, and the implementation phase is the execution of that plan.

Based on the two simultaneous analyses, the firm develops a plan to accomplish organizational goals and to exploit environmental opportunities through the deployment of its strengths. In doing so, the firm should be careful not to expose its weaknesses and should be prepared to face threatening conditions or avoid them altogether. The process is concluded when a control mechanism shows that the strategy process is being properly executed



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There are no substantive differences between the strategic planning processes of a domestic company and an MNC. The strategic process, for both domestic and MNCs, entails aligning organizational capabilities with the changing environmental conditions to achieve organizational goals.

Regardless of the nature of the operation, the strategic management process remains basically the same for the domestic enterprise and the MNC. Just because a firm expands abroad, it does not mean that there will be a different strategy formulation and implementation process.

By expanding to foreign markets, however, the firm will encounter additional complexity from operating across national borders. Internationalization of the firm brings about many new problems that require careful resolution. These new problems increase the burden of managing an MNC.

The multiplicity of cultural, sociopolitical, legal, and economic environments creates quantitative and qualitative difficulties. Quantitatively, there are many national markets, each with its own requirements and problems that demand special attention. Qualitatively, because of historical, cultural, political, and economic variations, each national market is unique



Fig. 6.1 Strategy formulation process

- The central issue in strategy formulation is the identification of environmental factors that may have an influence on the organization and preparation of a plan of action to deal with them.
- The difference in strategy formulation and implementation processes between a domestic and an international operation is in the degree of environmental and organizational complexities and uncertainties

International operations are more complex:

because of environmental uncertainties and complexities (e.g., cultural, institutional, and economic environment).

The major international environmental factors include:

- **Cultural differences**
- **Host government, political, and legal issues**
- **Competition from local businesses, government agencies, and other MNCs**

We discussed the cultural differences in Chap. 3. The following sections delineate the host government, political, and legal issues and the competition. And the strategic implications in dealing with the host government and host country competition will be discussed

Host Government, Political, and Legal Issues:

The most influential of all international environmental forces are political, legal, and governmental. Legal and political issues could hinder the MNCs' overseas operations.

The lack of understanding of local laws could cost the MNCs dearly. The political turmoil that simmers under the surface may be very difficult for outsiders to detect. Yet an inappropriate response could result in substantial earning and property loss.

Host governments use their sovereign power by restricting or assisting MNCs. When host countries believe that the operation of MNCs is compatible with their national goals, they may provide various incentives to attract and maintain MNC operations. If, however, the activities of the MNCs do not meet the host governments' expectations, many restrictions and obstacles are routinely placed in their paths. At the heart of this difficulty lies the difference between the objectives of the host countries and those of the MNCs.

- **Host governments have a love-hate relationship with MNCs.**
- It is safe to say that the feeling is mutual. In general, this feeling is more intense in the case of developing nations. The power of MNCs and the fact that they operate across national borders make their operations less susceptible to influence and control by the host governments. When the strategic requirements of MNCs are not compatible with the host government's economic plans, the relationship may not be very beneficial to the host country. The power, resources, and flexibility of MNCs could overwhelm most host governments' plans and render them less effective.

Factors Affecting the Bargaining Power of MNCs and the Host Government

the host governments and MNCs have a very complex and interdependent relationship. Business transactions and operations of MNCs are determined by the relative bargaining power between MNCs and the host government.

Bargaining Power of MNCs:

An MNC's relative bargaining power increases under five conditions—

first, if it has a monopolistic position;

second, if it uses a technology that requires a large investment in R&D, without many viable substitutes;

third, if it exports a large part of its outputs and has control over the market downstream (e.g., distribution channels);

fourth, if it employs factors of production, such as labors, that are easily substitutable across countries;

and fifth, if its operations require a small investment that could very easily be liquidated or moved, meaning that the operations are relatively immune from excessive pressures on the part of the host government

Bargaining Power of the Host Government:

Just as there are certain conditions that increase the relative power of MNCs, there are also conditions that influence the relative bargaining power of host countries. A country in the early stages of economic development that is heavily dependent on technology importation may be in a weak bargaining position vis-à-vis the MNCs.

For these countries, the MNCs are the only vehicle of technology transfer, and they cannot afford to alienate them. In general, the relative power of the host government depends on control over three factors: **access to product markets, access to the domestic capital market, and access to production technology**

Host governments have the power to control access to domestic markets, and they usually exercise this power. The importance of access to a domestic market is a function of one or a combination of three factors.

First, the MNC may desire **access to the market** because of its size. China, India, Brazil, and Mexico have large domestic markets. Their huge size and the fact that these markets cannot be supplied by locating plants in other countries make them attractive to MNCs. The low purchasing power in these countries, however, tempers their attractiveness. The control over a large domestic market gives the government a monopoly power, similar to that enjoyed by countries with desirable raw materials that are in limited supply

Second, a market may be attractive to MNCs because of its export potential. As part of its global strategy, an MNC may be interested in a country's low labor costs for setting up export-oriented manufacturing facilities.

This is a major reason why some MNCs have established manufacturing facilities in China.

Third, a country's domestic market could be attractive due to its membership in a regional trade pact. It could be used for entry into a market that would otherwise be difficult to access. Each of the members of the European Union, for example, could be an attractive alternative for reaching the European market.

In sum, increased bargaining power of the host government allows to better control MNCs' activities, alleviate their negative impacts on the economies of the host country, and protect the labor market and industry.

On the other hand, the bargaining power of MNCs can be a weapon to negotiate with the host government, particularly when MNCs face challenging issues of business operation (e.g., strict regulations on FDI and government requirements). The success of MNCs depends upon how well they manage host government relations.

Managing Host Government Relations MNCs handle government relations and respond to government demands and policy actions in many different ways. The response to government actions and demands may be centralized at headquarters, placed with the regional managers, or delegated to the country managers.

The latter method, however, is not very popular with MNCs. Usually, country managers have limited authority and autonomy in their dealings with host governments

Mahini and Wells have identified four factors that largely determine the location of decision response in the organizational hierarchy and the method of handling host government relations:

- 1. The firm's bargaining power in dealing with host governments.**
- 2. The significance of the international operations to the enterprise.**
- 3. The degree of interdependence of the subsidiaries.**
- 4. The political salience of the industry, where the industry accounts for the major part of the host country's foreign exchange earnings and the host government revenues**

Considering these factors, there are four different approaches to host government relations:

- 1. Centralized-fixed**
- 2. Centralized-flexible**
- 3. Decentralized**
- 4. Decentralized-centralized (combined/coordinated)**

Centralized-Fixed Approach

The major areas of possible conflict with host governments are identified in advance, and policies are devised for handling them. Once the policies to handle the host government issues are set up, these policies are usually nonnegotiable and fixed.

This approach might be employed where the firm is in a very strong bargaining position and the host government is dependent on the resources of the firm. Although the policies are made centrally at headquarters, the host government deals with the local MNC managers who implement them.

Centralized-Flexible Approach

This approach directs and supervises government negotiations from headquarters. The difference between the centralized-fixed approach and the centralized-flexible approach is in their dealing with the most important government relation matters.

In the centralized-flexible approach, the headquarters is willing to negotiate on issues and flexibly alter policies.

Decentralized Approach



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Foreign subsidiaries are responsible for host government relations. In this case, the headquarters grant a great degree of autonomy to subsidiaries as to the host government relations (e.g., negotiation and problem-solving). And thus, the control of headquarters is now decentralized.

Depending on the issues at hand, the foreign subsidiaries, the regional manager, or a functional department such as marketing might be responsible for host government relations. The decentralized approach seems to be more appropriate when subsidiaries are geographically diversified and when there is a low (or zero) degree of interdependency between subsidiaries in different countries

Decentralized-Centralized (Combined/Coordinated) Approach



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A middle ground approach, between the extreme positions of the centralized and decentralized approaches, is followed by firms using the combined/coordinated approach. This approach involves frontline managers, while headquarters maintain some degree of centralization.

Although foreign subsidiaries can directly negotiate with the host government and deal with issues in the host country, the headquarters can be involved in the negotiation and decision-making process

The Competition environment

A major difference between the management of MNCs and that of the domestic firm is the nature of the competition each faces. MNCs operate in a more competitive environment. In some or all aspects of their operations, many MNCs have to deal with competition from local and state-owned firms. Besides the competition from local firms, rivalry among MNCs creates very intense competitive pressure.

Governments' involvement in business creates an environment of constraints and control. Through direct or indirect support and subsidies of local businesses, governments force MNCs to evaluate their strategies carefully.



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Competition from Domestic and State-Owned Enterprises Exclusive Distribution Channels:

Domestic firms have an edge over the MNCs due to their insider position and familiarity with the cultural, legal, and logistical requirements of doing business. In some countries, the stigma of being a foreign company is by itself a drawback.

The older generation of Japanese managers, for example, is still reluctant to deal with foreign companies. They tend to consider it unpatriotic to buy from the foreigners. Some US firms have capitalized on consumers' patriotic feelings as well. Walmart, for example, has used its support of American suppliers, whenever these suppliers are competitive on quality and price, as an effective marketing tool

In addition, host governments can control an industry without an ownership share. A host government may be the only customer of the industry's products, and through its purchasing power, it can effectively bar MNC participation in that industry. By buying only from domestic firms, governments can create artificial entry barriers.

Exclusive domestic purchasing may not be a formal government policy but a de facto practice. Nor does it have to be practiced only by the government to have an impact on MNC participation in the industry



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Protection of Key Industries:

Certain industries are considered by host governments to be strategically important for national security, and these industries receive government support to compete with MNCs. Host government policies regarding domestic strategic industries vary. In some countries, these industries are government owned. In other countries, they are the exclusive domain of domestic firms, with the government effectively controlling them. In still others, MNCs are allowed limited participation in some aspects but are barred from others

- **Potential Strategy to Remove Entry Barriers (Technology Offerings):**
- In obtaining a new business contract in the government-controlled industries of developing countries, MNCs that can offer new technologies have a competitive advantage over those who cannot, or are unwilling to, do so. As noted, developing countries are very interested in technology transfer. For example, CIT-Alcatel, the French supplier of switching equipment, was able to win a sizable contract from the Indian government by providing technological assistance.
- CIT-Alcatel agreed to set up an Indian digital telecommunication equipment industry, backed by a guarantee and agreements between the French and Indian governments



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Competition from Other MNCs :

Competition to MNC operation comes from other MNCs, as well as domestic firms. The nature of the competition, of course, varies with industry characteristics. For the automobile and consumer electronics industries, for example, competition is not limited to the MNCs in developing countries, because they employ mature technologies and have products and market characteristics that are less influenced by cultural norms. Similarities in consumer tastes and preferences provide opportunities for standardization in manufacturing and economies of scale, making them very attractive



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To encourage exports, many governments provide subsidies to domestic firms. With financial, and sometimes technological, assistance from governments, international markets are becoming the scene of very intense competition.

For instance, Airbus Industries, a consortium of aviation firms from Europe backed by the French and British governments, has made successful inroads into markets that previously were exclusively served by Boeing. Airbus has used these subsidies to develop a technologically advanced passenger airplane and undercut Boeing prices. Consequently, in recent years, even some American airlines have chosen Airbus over Boeing.

Industry Characteristics and MNC Strategy:

Firms depending on their industries may have different international business strategies. For instance, Apple Inc. producing standardized products (e.g., iPhone, iPad, and Mac computers) does not differ designs, features, and functionalities across countries. And the firm centralized its value-creation activities (e.g., manufacturing and R&D) in few locations; iPhones are assembled in China and exported to worldwide markets.

However, firms like McDonald's vary its food menus (e.g., no beef-based Big Mac in India and bagel cheeseburger in France) to better cater the local markets and change store policies in some countries (e.g., smoking has been allowed in McDonald's stores in Japan till 2014, not anymore though). As such, firms can alter global business strategies based on two dimensions:

(1) requirements for global integration

(2) requirements for local market adaptation

requirements for Global Integration



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Firms are more required to integrate their value-creation activities (e.g., manufacturing, marketing, and R&D) across countries by centralizing the location of value-creation activities and standardizing product specifications.

Firms usually have few manufacturing plants in a few locations where mass production is possible and involve in minimal product modification and adaptation. A typical example of firm that focuses on global integration is Apple Inc.

requirements for Local Market Adaptation



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Firms are more required to adapt local market environments. Product requirements including product specifications, sizes, colors, shapes, tastes, functions, and features are usually high. And the business operations need to be modified depending upon each individual market characteristics such as local government requirements or regulations, unique distribution channels, and service needs/expectations. For instance, the requirements for local market adaptation are significant for firms in food and drink industries, where customers have different preferences and tastes and where a popular business.



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Based on these two dimensions, we can classify four industries:

- international,
- multidomestic,
- global,
- and transnational industry.

International Industries

The dominance of technological forces and the need to develop and distribute innovations in multiple markets are characteristics of international industries. Success in these industries depends on the ability to exploit technological forces, produce new products, and duplicate the process in different national markets.

Typically, new products are developed in the home market. Then, these products are exported to foreign markets, and their related technologies are sequentially applied to other national markets. Since competitive advantage hinges on expensive technological development, the ability to duplicate the technology in multiple markets is an economic necessity.

Multidomestic Industries

are characterized by local product and market requirements. National, cultural, social, and political differences lead to diverse product standards and different consumer tastes. These differences create a strong need for customized products to meet local tastes and preferences. The operational requirements of multidomestic industries are on a national scale. Therefore, separate manufacturing facilities, to serve each national market independently, are economical. There are no economies of scale in functional areas, such as R&D and marketing

MNCs' international expansion can be attributed to their ability to exploit the economies of scale and experience, location, product differentiation, process technology, and control of distribution channels. The exploitation of some of these advantages is possible only with a global integration strategy. Certain technologies and products require a huge investment in R&D and manufacturing facilities. In such situations, organizational efficiency demands a large production run and a market share on a global scale.

Four MNC Strategies

In dealing with environmental complexities and uncertainties, MNCs have a range of alternative strategic choices. Because there are some similarities as well as differences among national markets, the choice of strategy is determined by considering these similarities and differences. Depending on the circumstances, firms can establish a middle-ground position and lean toward either one or the other. These choices are presented under four MNC strategies: (1) international, (2) host country focus, (3) global integration, (4) transnational.

1/ International strategy

is suitable for firms in international industries where they focus on manufacturing products that serve universal needs such as raw materials and basic product parts. Since the international strategy requires a low level of global integration and local market adaptation, and its implementation costs are not significantly high, it is preferable among small firms. Those small firms focusing on domestic businesses have relatively less international business experience and thus tend to replicate their domestic business strategies when they involve in foreign operations through an exporting or a sales office

2/Host Country Focus Strategy

is the “effectiveness” option rather than “efficiency” through global integration. In a host country focus strategy, subsidiaries are treated as if they are autonomous national firms. They are allowed to respond to local demands as they see fit. The MNC’s headquarters maintains overall coordination among various subsidiaries in a way that maximizes the MNC’s global performance. A relatively complete range of products is manufactured by each subsidiary. Since each subsidiary is responsible for its own domestic market needs, a minimum amount of trade occurs between subsidiaries in different countries. Consequently, subsidiaries are not directly responsible for the total MNC efficiency

3/Global Integration Strategy

To capitalize on the economies of scale and to take advantage of the diverse opportunities for cost reduction that the global market provides, the choice of strategy is global integration. Following a global integration strategy, MNC production and distribution facilities expand over national borders in a network of specialized operations. Firms using a global integration strategy capitalize on the similarities among the national markets and sidestep the differences. **Global integration can be based on product or process specialization as following:**

MNCs using product specialization:

produce only part of a common global product range in each country. Each foreign subsidiary, however, offers a complete range of products in its national market. Through intrafirm trade, each subsidiary imports from other subsidiaries what it is not producing and exports to them its specialized outputs.

Process Specialization

The process specialization involves a multistage manufacturing process, where each subsidiary produces certain parts and components for a common product or product range. American semiconductors ha

4/Transnational Strategy

In choosing a combined transnational strategy, the MNC intends not to be committed to the extreme positions of global integration and host country focus. Both extreme strategies have certain shortcomings. As noted, the global integration foregoes the flexibility of the host country focus, whereas the host country focus does not enjoy the economies of scale and efficiency of global integration. A transnational strategy aims to combine both features and, therefore, enables the MNCs to decide each major situation based on its own merits and plan accordingly. For example, faced with a saturated market for soup in the United States, Campbell Soup is expanding abroad with locally responsive strategies

The transnational strategy is ambiguous compared with the clarity of the other two strategies. It is an option when there is no clear-cut preference for either global integration or host country focus strategies. It attempts to trade off the costs and benefits of the other two strategies on a case-by-case basis to maximize the overall results. Some situations may call for a host country focus strategy, with limited opportunity for global integration. Other situations may allow global integration, with moderate responsiveness to the host government's demands. Maintaining some manufacturing and R&D facilities and forming joint ventures with domestic firms in each country, for example, could satisfy host government demands yet allow for corporate-wide integration.

The transnational strategy requires a coordination capability: the ability to respond quickly to changing situations and to shift different aspects of the operation among countries when circumstances change. If interventions by host governments create unacceptable conditions, the MNC should have the alternative of shifting its priorities between national subsidiaries. It also calls for a close working relationship between the managers of national subsidiaries and host government officials. Headquarters, therefore, has to rely on the managers of national subsidiaries and permit their involvement in major decisions. Because of their working relationships with the local community and host government officials, these managers are in the best position to assess the need for local responses.

Resources:

Kamal Fatehi & Jeongho Choi

International Business Management

Succeeding in a Culturally Diverse World, Second Edition

Chapter 5