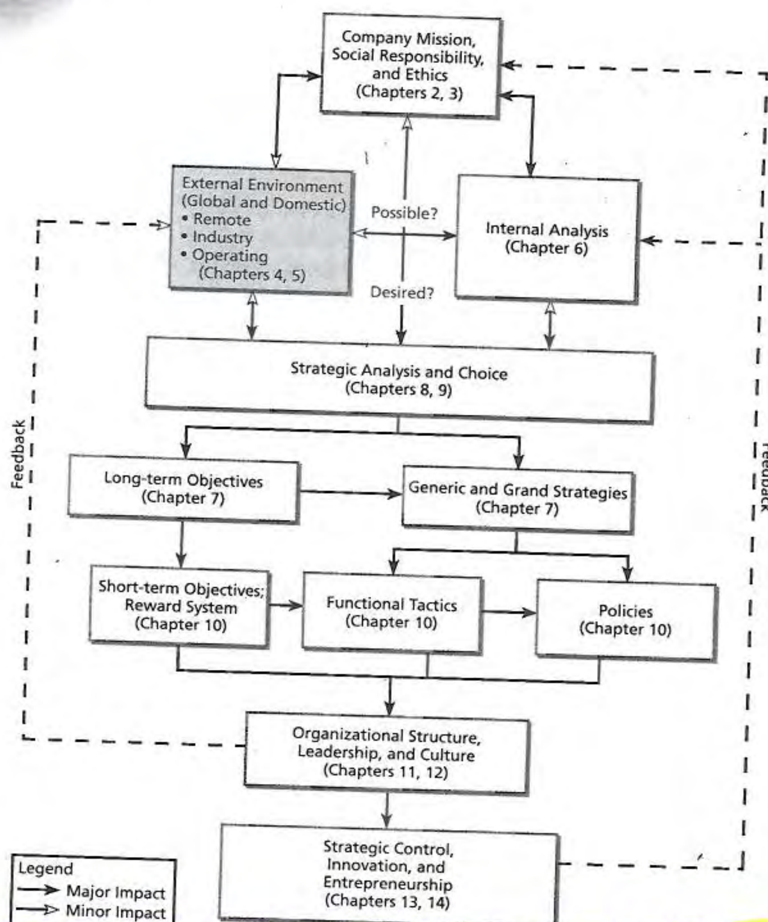
Chapter **Five**

The Global Environment

After reading and studying this chapter, you should be able to

1. Explain the importance of a company's decision to globalize.
2. Describe the four main strategic orientations of global firms.
3. Understand the complexity of the global environment and the control problems that are faced by global firms.
4. Discuss major issues in global strategic planning, including the differences for multinational and global firms.
5. Describe the market requirements and product characteristics in global competition.
6. Evaluate the competitive strategies for firms in foreign markets, including niche market exporting, licensing and contract manufacturing, franchising, joint ventures, foreign branching, private equity, and wholly owned subsidiaries.



Pearce, J.A. & Robinson, R.B. (2011). Strategic Management (12th ed.). New York, NY: McGraw Hill

GLOBALIZATION

Globalization
The strategy of pursuing opportunities anywhere in the world that enable a firm to optimize its business functions in the countries in which it operates.

Globalization refers to the strategy of pursuing opportunities anywhere in the world that enable a firm to optimize its business functions in the countries in which it operates. A company with global sales may have its high value-added software design activity done in Ireland, while it may achieve its lowest manufacturing costs by outsourcing those activities to India.

There are two main theories concerning the introduction of a product globally: standardization and customization. Standardization is the use of a common product, service, and message across all markets to create a strong brand image. The constantly improving communication technology in the twentieth century led to an ever-more-homogenous global customer base that allowed for strategic success with a standardized product. Standardization performed well until the late 1990s, when global brand owners saw their share prices drop as consumers reached for local products that were better aligned with their cultural identities. The change in customer purchase behavior was the beginning of an evolution in international strategy.

Since then, standardization is steadily being replaced by customization, which is the development of modified products and services, and the use of somewhat tailor-made messages, to meet the demands of a local population.

Coca-Cola's CEO from 2000 to 2004, Douglas Daft, famously argued that globalization strategies had to adapt to the times, saying that multinational firms needed to "Think global. Act local." His approach, which combines global standardization with some local customization, is now widely accepted within the Coca-Cola Corporation, as well as by other global superstars, including McDonald's and Wal-Mart. The approach allows the company to build a global brand image while creating products to meet the local demands of the target market. For Coca-Cola, this strategy has resulted in a ranking as the number one global brand in carbonated beverages, while producing more than 450 localized brands in more than 200 countries. Refer to Exhibit 5.1, Global Strategy in Action, to read about Coke's recent major globalization efforts.

Awareness of the strategic opportunities faced by global corporations and of the threats posed to them is important to planners in almost every domestic U.S. industry. Among corporations headquartered in the United States that receive more than 50 percent of their annual profits from foreign operations are Citicorp, Coca-Cola, ExxonMobil, Gillette, IBM, Otis Elevator, and Texas Instruments. In fact, the 100 largest U.S. globals earn an average of 37 percent of their operating profits abroad. Equally impressive is the effect of foreign-based globals that operate in the United States. Their "direct foreign investment" in the United States now exceeds $90 billion, with Japanese, German, and French firms leading the way.

Understanding the myriad and sometimes subtle nuances of competing in global markets or against global corporations is rapidly becoming a required competence of strategic managers. For example, experts in the advertising community contend that Korean companies only recently recognized the importance of making their names known abroad. In the 1980s, there was very little advertising of Korean brands, and the country had very few recognizable brands abroad. Korean companies tended to emphasize sales and production more than marketing. The opening of the Korean advertising market in the 1990s indicated that Korean firms had acquired a new appreciation for the strategic competencies that are needed to compete globally and created an influx of global firms like Saatchi and Saatchi, J. W. Thompson, Ogilvy and Mather, and Bozell. Many of them established joint ventures or partnerships with Korean agencies. An excellent example

Global Strategy in Action — Exhibit 5.1

Coca-Cola-Follows Its Motto: "Think global. Act local."

In 2008, Coca-Cola Co. bought China Huiyuan Juice Group Ltd. for $2.4 billion. The price reflected a value for Huiyuan of 45 times the company's estimated annual earnings. This is a valuable asset for Coca-Cola due to Huiyuan's position as the leading fruit and vegetable juice company in China. Huiyuan Juice produces more than 220 brands of fruit and vegetable juice and enjoys an industry-leading market share of 10.3 percent, with Coca-Cola in second place with 9.7 percent of the market. Coca-Cola's strategy in China is a prime example of "Think global. Act local."

The acquisition of Huiyuan helps with the localization aspect of Coca-Cola's strategy in China. Although Coca-Cola is best known for its carbonated beverage, the Chinese population prefers the tastes of juice to Coca-Cola's traditional products. The 2008 demand for juice in China was 10 billion liters compared to only 9.6 billion liters of soda. At the time, Euromonitor International estimated that fruit and vegetable juice sales would grow by 16 percent, which was more than double the growth of carbonated drinks. The projected growth was based on the health consciousness of Chinese consumers, who often opt for healthier teas and juices over carbonated beverages.

Source: Stephanie Wong, "Coca-Cola to Buy China's Huiyuan for $2.3 Billion," *Bloomberg.com,* September 3, 2008.

of such a strategic approach to globalization by Philip Morris's KGFI is described in Exhibit 5.2, Global Strategy in Action. The opportunities for corporate growth often seem brightest in global markets. Exhibit 5.3 reports on the growth in national shares of the world's outputs and growth in national economies to the year 2020. While the United States had a commanding lead in the size of its economy in 1992, it was caught by China in the year 2000 and will be far surpassed by 2020. Overall, in less than 20 years, rich industrial countries will be overshadowed by developing countries in their produced share of the world's output.

Because the growth in the number of global firms continues to overshadow other changes in the competitive environment, this section will focus on the nature, outlook, and operations of global corporations.

DEVELOPMENT OF A GLOBAL CORPORATION

The evolution of a global corporation often entails progressively involved strategy levels. The first level, which often entails export-import activity, has minimal effect on the existing management orientation or on existing product lines. The second level, which can involve foreign licensing and technology transfer, requires little change in management or operation. The third level typically is characterized by direct investment in overseas operations, including manufacturing plants. This level requires large capital outlays and the development of global management skills. Although the domestic operations of a firm at this level continue to dominate its policy, such a firm is commonly categorized as a true multinational corporation (MNC). The most involved strategy level is characterized by a substantial increase in foreign investment, with foreign assets comprising a significant portion of total assets. At this level, the firm begins to emerge as a global enterprise with global approaches to production, sales, finance, and control.

To get a more complete understanding of the many elements of a multinational environment that need to be considered by strategic planners, study the Chapter 5 Appendix. It contains lists of important competitive issues that will help you to see the complexity of the multinational landscape and to better appreciate the complicated and sophisticated nature of strategic planning.

Global Strategy in Action

Exhibit 5.2

The Globalization of Philip Morris's KGFI

Outside of its core Western markets, Kraft General Foods International's (KGFI) food products have a growing presence in one of the most dynamic business environments in the world—the Asia-Pacific region. Its operations there are expanding rapidly, often aided by links with local manufacturers and distributors.

Japan and Korea are important examples. In both countries, local alliances can be crucial to market entry and success. Realizing this fact in the early 1970s, General Foods established joint ventures in both Japan and Korea. These joint ventures, combined with Kraft General Foods International's (KGFI) stand-alone operations, generate more than $1 billion in revenues. In the aggregate, their combined food operations in Japan and Korea are larger than many *Fortune* 500 companies.

Whereas soluble coffee accounts for just over 25 percent of the coffee consumed in U.S. homes, it fills more than 70 percent of the cups consumed in the homes of convenience-minded Japan. Additionally, Japan is the origin of a unique form of packaged coffee—liquid—and a unique channel of distribution—vending machines. Japanese consumers have purchased packaged liquid coffee for years, and it amounts to a $5 billion category. Some 2 million vending machines dispense 9 billion cans of liquid coffee annually—an average of 75 cans per person.

Japan offers a culturally unique distribution channel for coffee products—the gift-set market. Many Japanese exchange specially packaged food or beverage assortments at least twice a year to commemorate holidays as well as special personal or business occasions. The gift-set business has helped Maxim products reinforce their quality image; it also will be a launching pad and support vehicle for Carte Noire coffees.

Outside the Ajinomoto General Foods joint venture, KGFI is developing a freestanding food business under the name Kraft Japan. It is building a cheese business with imported Philadelphia Brand cream cheese, the leading cream cheese in the Tokyo metropolitan market, as well as locally manufactured and licensed Kraft Milk Farm cheese slices. The cheese market is expected to grow approximately 5 percent per year. This is a rapid growth rate for a large food category. In addition to cheese, KGFI also imports Oscar Mayer prepared meats and Jacobs Suchard chocolates.

KGFI's joint venture in Korea, Doug Suh Foods Corporation, is one of the top 10 food companies in the country. Doug Suh manufactures coffees and cereals and has its own distribution network. One of Doug Suh's other businesses in Korea, Post Cereals, is also a strong number two, with a 42 percent category share.

Korea's $400 million coffee market is the fastest-growing major coffee market in the world, expanding at an average annual rate of 14 percent. Growing with the market, Maxim and Maxwell soluble coffees, in both traditional "agglomerate" and freeze-dried forms, account for more than 70 percent of the country's soluble coffee sales. The strength of these brands also brings the company a strong number one position in coffee mix, a mixture of soluble coffee, creamer, and sugar. In addition, its Frima brand leads the market in the nondairy creamer segment.

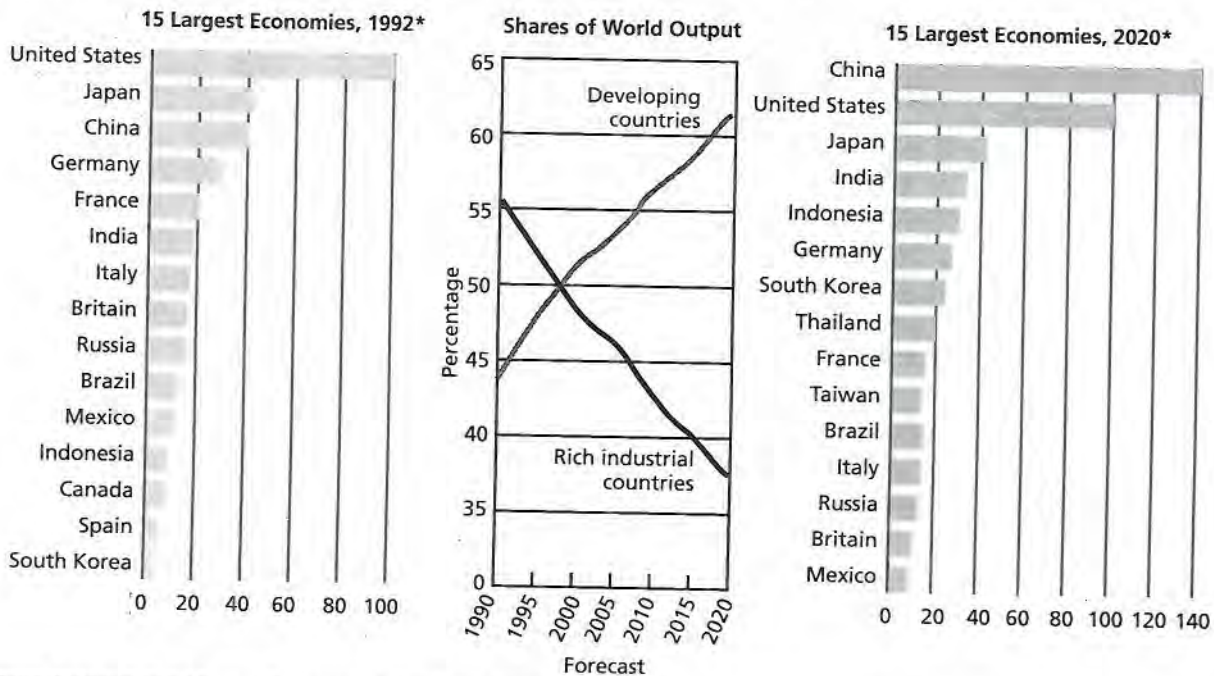
Beyond Japan and Korea, KGFI is targeting many other countries for geographic expansion. In Indonesia, for instance, KGFI has established a rapidly growing cheese business through a licensee and introduced other KGFI products. In Taiwan, the joint venture company, PremierFoods Corporation, holds a 34 percent share of the soluble coffee market and is aggressively developing a Kraft cheese and Jacobs Suchard import business. KGFI Philippines, a wholly owned subsidiary, has a leading position in the cheese and powdered soft-drink markets in its country. In the People's Republic of China, the company produces and markets Maxwell House coffees and Tang powdered soft drinks through two successful and rapidly growing joint ventures.

Some firms downplay their global nature (to never appear distracted from their domestic operations), whereas others highlight it. For example, General Electric's formal statement of mission and business philosophy includes the following commitment:

> To carry out a diversified, growing, and profitable worldwide manufacturing business in electrical apparatus, appliances, and supplies, and in related materials, products, systems, and services for industry, commerce, agriculture, government, the community, and the home.

A similar global orientation is evident at IBM, which operates in 125 countries, conducts business in 30 languages and more than 100 currencies, and has 23 major manufacturing facilities in 14 countries.

EXHIBIT 5.3 Projected Economic Growth



Source: World Bank, *Global Economic Prospects and the Developing Countries.*

WHY FIRMS GLOBALIZE

The technological advantage once enjoyed by the United States has declined dramatically during the past 30 years. In the late 1950s, more than 80 percent of the world's major technological innovations were first introduced in the United States. By 1990, the figure had declined to less than 50 percent. In contrast, France is making impressive advances in electric traction, nuclear power, and aviation. Germany leads in chemicals and pharmaceuticals, precision and heavy machinery, heavy electrical goods, metallurgy, and surface transport equipment. Japan leads in optics, solid-state physics, engineering, chemistry, and process metallurgy. Eastern Europe and the former Soviet Union, the so-called COMECON (Council for Mutual Economic Assistance) countries, generate 30 percent of annual worldwide patent applications. However, the United States has regained some of its lost technological advantage. Through globalization, U.S. firms often can reap benefits from industries and technologies developed abroad. Even a relatively small service firm that possesses a distinct competitive advantage can capitalize on large overseas operations.

Diebold Inc. once operated solely in the United States, selling automated teller machines (ATMs), bank vaults, and security systems to financial institutions. However, with the U.S. market saturated, Diebold needed to expand internationally to continue its growth. The firm's globalization efforts led to both the development of new technologies in emerging markets and opportunistic entry into entirely new industries that significantly improved Diebold's sales.

In many situations, global development makes sense as a competitive weapon. Direct penetration of foreign markets can drain vital cash flows from a foreign competitor's domestic operations. The resulting lost opportunities, reduced income, and limited production can impair the competitor's ability to invade U.S. markets. A case in point is IBM's

move to establish a position of strength in the Japanese mainframe computer industry before two key competitors, Fugitsu and Hitachi, could dominate it. Once IBM had achieved a substantial share of the Japanese market, it worked to deny its Japanese competitors the vital cash and production experience they needed to invade the U.S. market.

Firms that operate principally in the domestic environment have an important decision to make with regard to their globalization: Should they act before being forced to do so by competitive pressures or after? Should they (1) be proactive by entering global markets in advance of other firms and thereby enjoy the first-mover advantages often accruing to risk-taker firms that introduce new products or services or (2) be reactive by taking the more conservative approach and following other companies into global markets once customer demand has been proven and the high costs of new-product or new-service introductions have been absorbed by competitors?

ethnocentric orientation
When the values and priorities of the parent organization guide the strategic decision making of all its international operations.

polycentric orientation
When the culture of the country in which the strategy is to be implemented is allowed to dominate a company's international decision-making process.

regiocentric orientation
When a parent company blends its own predisposition with those of its international units to develop region-sensitive strategies

geocentric orientation
When an international firm adopts a systems approach to strategic decision making that emphasizes global integration.

Strategic Orientations of Global Firms

Multinational corporations typically display one of four orientations toward their overseas activities. They have a certain set of beliefs about how the management of foreign operations should be handled. A company with an **ethnocentric orientation** believes that the values and priorities of the parent organization should guide the strategic decision making of all its operations. If a corporation has a **polycentric orientation,** then the culture of the country in which a strategy is to be implemented is allowed to dominate the decision-making process. In contrast, a **regiocentric orientation** exists when the parent attempts to blend its own predispositions with those of the region under consideration, thereby arriving at a region-sensitive compromise. Finally, a corporation with a **geocentric orientation** adopts a global systems approach to strategic decision making, thereby emphasizing global integration.

American firms often adopt a regiocentric orientation for pursing strategies in Europe. U.S. e-tailers have attempted to blend their own corporate structure and expertise with that of European corporations. For example, Amazon has been able to leverage its experience in the United States while developing regionally and culturally specific strategies overseas. By purchasing European franchises that have had regional success, E*Trade is pursuing a foreign strategy in which they insert their European units into their corporate structure. This strategy requires the combination and use of culturally different management styles and involves major challenges for upper management.

Exhibit 5.4 shows the effects of each of the four orientations on key activities of the firm. It is clear from the figure that the strategic orientation of a global firm plays a major role in determining the locus of control and corporate priorities of the firm's decision makers.

AT THE START OF GLOBALIZATION

External and internal assessments are conducted before a firm enters global markets. For example, Japanese investors conduct extensive assessments and analyses before selecting a U.S. site for a Japanese-owned firm. They prefer states with strong markets, low unionization rates, and low taxes. In addition, Japanese manufacturing plants prefer counties characterized by manufacturing conglomeration; low unemployment and poverty rates; and concentrations of educated, productive workers.

External assessment involves careful examination of critical features of the global environment, particular attention being paid to the status of the host nations in such areas as economic progress, political control, and nationalism. Expansion of industrial facilities,

EXHIBIT 5.4 Orientation of a Global Firm

	Orientation of the Firm			
	Ethnocentric	Polycentric	Regiocentric	Geocentric
Mission	Profitability (viability)	Public acceptance (legitimacy)	Profitability and public acceptance (viability and legitimacy)	Same as regiocentric
Governance	Top-down	Bottom-up (each subsidiary decides on local objectives)	Mutually negotiated between region and its subsidiaries	Mutually negotiated at all levels of the corporation
Strategy	Global integration	National responsiveness	Regional integration and national responsiveness	Global integration and national responsiveness
Structure	Hierarchical product divisions	Hierarchical area divisions, with autonomous national units	Product and regional organization tied through a matrix	A network of organizations (including some competitors)
Culture	Home country	Host country	Regional	Global
Technology	Mass production	Batch production	Flexible manufacturing	Flexible manufacturing
Marketing	Product development determined by the needs of home country	Local product development based on local needs	Standardize within region but not across regions	Global product, with local variations
Finance	Repatriation of profits to home country	Retention of profits in host country	Redistribution within region	Redistribution globally
Personnel practices	People of home country developed for key positions in the world	People of local nationality developed for key positions in their own country	Regional people developed for key positions anywhere in the region	Global personnel development and placement

Source: From *Columbia Journal of World Business*, Summer 1985, by B.S. Chukravarthy and Howard V. Perlmuter, "Strategic Planning for a global Business," p. 506. Copyright © Elsevier 1985.

favorable balances of payments, and improvements in technological capabilities over the past decade are gauges of the host nation's economic progress. Political status can be gauged by the host nation's power in and impact on global affairs.

Understanding the political risk involved is a key element in the decision to do business in a foreign nation. Opportunities for fast growth and attractive profits often arise in countries with suspect political risk. The principal concern of foreign direct investors is whether the foreign government is able to implement its policies during a period of political, social, or economic upheaval. If it can, the country is judged to be stable. Stability provides investors with confidence that the country's regulatory environment will enable it to achieve the economic returns that it deserves.

A second issue that concerns investors is how the stability in a foreign nation is achieved. Strategists often place a country's openness along a simple continuum from closed to open. Closed countries maintain their stability by restricting the flow of money, goods, services, people, and information across their borders. Countries that tend toward this extreme include Cuba, Iran, and North Korea because their isolationist policies prevent their citizens from fully comprehending the conditions and options that are available in other countries.

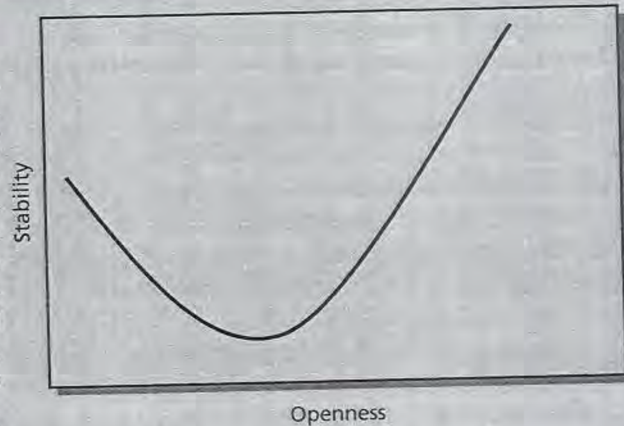
Strategy in Action

Exhibit 5.5

The J-Curve on Country Stability and Openness

The J-curve represents the relationship between stability and openness as shown in the accompanying figure. Each country moves along its own J-curve and the curve itself shifts up and down with fluctuations in the economy. Nations higher on the graph are more stable; those lower are less stable. Nations to the right of the dip in the J are more open; those to the left less open. As a country that is stable because it is closed becomes more open, it slides down the left side of the curve toward the dip in the J, the point of greatest instability. So, for example, if Pakistan, Myanmar, or Cuba held elections next week, political turmoil would likely erupt. If North Koreans had access to South Korea media for a week, Kim Jong Il would have plenty to fear.

The irony is that the energies of globalization and growth in demand for key commodities are driving more businesses to contemplate ventures in politically closed countries, particularly China. But those same energies may destabilize the ground beneath unwary businesses' feet.



Source: From "Prepare to Lose It all? Read on . . . How to Calculate Political Risk," by Ian Bremmer, *Inc. Magazine*. Copyright © by Mansueto Ventures LLC. Reproduced with permission of Mansueto Ventures LLC via Copyright Clearance Center.

At the other extreme, many nations achieve their stability by allowing and encouraging exchanges among their and business and public institutions, and their citizens and those of other nations. Examples include the countries in Australia, Brazil, the European zone, Japan, and the United States.

Exhibit 5.5, Strategy in Action, describes the J-curve, a useful approach for evaluating the relationship between stability and openness and an important element in political risk assessment.

Internal assessment involves identification of the basic strengths of a firm's operations. These strengths are particularly important in global operations, because they are often the characteristics of a firm that the host nation values most and, thus, offer significant bargaining leverage. The firm's resource strengths and global capabilities must be analyzed. The resources that should be analyzed include, in particular, technical and managerial skills, capital, labor, and raw materials. The global capabilities that should be analyzed include the firm's product delivery and financial management systems.

A firm that gives serious consideration to internal and external assessment is Business International Corporation, which recommends that seven broad categories of factors be considered. As shown in Exhibit 5.6, Global Strategy in Action, these categories include economic, political, geographic, labor, tax, capital source, and business factors.

COMPLEXITY OF THE GLOBAL ENVIRONMENT

By 2003, Coke was finally achieving a goal that it had set a decade earlier when it went to India. That goal was to take the market away from Pepsi and local beverage companies. However, when it arrived, Coke found that the Indian market was extremely complex and smaller than it had estimated. Coke also encountered cultural problems,

Global Strategy in Action — Exhibit 5.6

Checklist of Factors to Consider in Choosing a Foreign Manufacturing Site

The following considerations were drawn from an 88-point checklist developed by Business International Corporation.

Economic Factors:

1. Size of GNP and projected rate of growth
2. Foreign exchange position
3. Size of market for the firm's products; rate of growth

Political Factors:

4. Form and stability of government
5. Attitude toward private and foreign investment by government, customers, and competition
6. Degree of antiforeign discrimination

Geographic Factors:

7. Proximity of site to export markets
8. Availability of local raw materials
9. Availability of power, water, gas

Labor Factors:

10. Availability of managerial, technical, and office personnel able to speak the language of the parent company
11. Degree of skill and discipline at all levels
12. Degree and nature of labor voice in management

Tax Factors:

13. Tax-rate trends
14. Joint tax treaties with home country and others
15. Availability of tariff protection

Capital Source Factors:

16. Cost of local borrowing
17. Modern banking systems
18. Government credit aids to new businesses

Business Factors:

19. State of marketing and distribution system
20. Normal profit margins in the firm's industry
21. Competitive situation in the firm's industry: do cartels exist?

in part because the chief of Coke India was an expatriate. The key to overcoming this cultural problem was promoting an Indian to operations chief. Coke also changed its marketing strategy by pushing their "Thums Up" products, a local brand owned by Coke. Then, they began to focus their efforts on creating new products for rural areas and lowering the prices of their existing products to increase sales. Once Coke had new products in the market, they focused on a new advertising campaign to better relate to Indian consumers.

Coke's experience highlights the fact that global strategic planning is more complex than purely domestic planning. There are at least five factors that contribute to this increase in complexity:

1. Globals face multiple political, economic, legal, social, and cultural environments as well as various rates of changes within each of them. Occasionally, foreign governments work in concert with their militaries to advance economic aims even at the expense of human rights. International firms must resist the temptation to benefit financially from such immoral opportunities.

2. Interactions between the national and foreign environments are complex, because of national sovereignty issues and widely differing economic and social conditions.

3. Geographic separation, cultural and national differences, and variations in business practices all tend to make communication and control efforts between headquarters and the overseas affiliates difficult.

4. Globals face extreme competition, because of differences in industry structures within countries.

5. Globals are restricted in their selection of competitive strategies by various regional blocs and economic integrations, such as the European Economic Community, the European Free Trade Area, and the Latin American Free Trade Area.

CONTROL PROBLEMS OF THE GLOBAL FIRM

An inherent complicating factor for many global firms is that their financial policies typically are designed to further the goals of the parent company and pay minimal attention to the goals of the host countries. This built-in bias creates conflict between the different parts of the global firm, between the whole firm and its home and host countries, and between the home country and host country themselves. The conflict is accentuated by the use of various schemes to shift earnings from one country to another in order to avoid taxes, minimize risk, or achieve other objectives.

Moreover, different financial environments make normal standards of company behavior concerning the disposition of earnings, sources of finance, and the structure of capital more problematic. Thus, it becomes increasingly difficult to measure the performance of international divisions.

In addition, important differences in measurement and control systems often exist. Fundamental to the concept of planning is a well-conceived, future-oriented approach to decision making that is based on accepted procedures and methods of analysis. Consistent approaches to planning throughout a firm are needed for effective review and evaluation by corporate headquarters. In the global firm, planning is complicated by differences in national attitudes toward work measurement, and by differences in government requirements about disclosure of information.

Although such problems are an aspect of the global environment, rather than a consequence of poor management, they are often most effectively reduced through increased attention to strategic planning. Such planning will aid in coordinating and integrating the firm's direction, objectives, and policies around the world. It enables the firm to anticipate and prepare for change. It facilitates the creation of programs to deal with worldwide development. Finally, it helps the management of overseas affiliates become more actively involved in setting goals and in developing means to more effectively utilize the firm's total resources.

An example of the need for coordination in global ventures and evidence that firms can successfully plan for global collaboration (e.g., through rationalized production) is the Ford Escort (Europe), the best-selling automobile in the world, which has a component manufacturing network that consists of plants in 15 countries.

GLOBAL STRATEGIC PLANNING

It should be evident from the previous sections that the strategic decisions of a firm competing in the global marketplace become increasingly complex. In such a firm, managers cannot view global operations as a set of independent decisions. These managers are faced with trade-off decisions in which multiple products, country environments, resource sourcing options, corporate and subsidiary capabilities, and strategic options must be considered.

stakeholder activism
Demands placed on a global firm by the stakeholders in the environments in which it operates.

A recent trend toward increased activism of stakeholders has added to the complexity of strategic planning for the global firm. **Stakeholder activism** refers to demands placed on the global firm by the foreign environments in which it operates, principally by foreign governments. This section provides a basic framework for the analysis of strategic decisions in this complex setting.

Multidomestic Industries and Global Industries

Multidomestic Industries

International industries can be ranked along a continuum that ranges from multidomestic to global.

multidomestic industry
An industry in which competition is segmented from country to country.

A **multidomestic industry** is one in which competition is essentially segmented from country to country. Thus, even if global corporations are in the industry, competition in one country is independent of competition in other countries. Examples of such industries include retailing, insurance, and consumer finance.

In a multidomestic industry, a global corporation's subsidiaries should be managed as distinct entities; that is, each subsidiary should be rather autonomous, having the authority to make independent decisions in response to local market conditions. Thus, the global strategy of such an industry is the sum of the strategies developed by subsidiaries operating in different countries. The primary difference between a domestic firm and a global firm competing in a multidomestic industry is that the latter makes decisions related to the countries in which it competes and to how it conducts business abroad.

Factors that increase the degree to which an industry is multidomestic include[1]

- The need for customized products to meet the tastes or preferences of local customers.
- Fragmentation of the industry, with many competitors in each national market.
- A lack of economies of scale in the functional activities of firms in the industry.
- Distribution channels unique to each country.
- A low technological dependence of subsidiaries on R&D provided by the global firm.

An interesting example of a multidomestic strategy is the one designed by Renault-Nissan for the low-cost automobile industry. Renault's strategy involves designing cars to fit the budgets of buyers in different countries, rather than being restricted to the production of cars that meet the safety and emission standards of countries in western Europe and the United States or by their consumer preferences for technological advancements and stylish appointments.

Global Industries

global industry
An industry in which competition crosses national borders on a worldwide basis.

A **global industry** is one in which competition crosses national borders. In fact, it occurs on a worldwide basis. In a global industry, a firm's strategic moves in one country can be significantly affected by its competitive position in another country. The very rapidly expanding list of global industries includes commercial aircraft, automobiles, mainframe computers, and electronic consumer equipment. Many authorities are convinced that almost all product-oriented industries soon will be global. As a result, strategic management planning must be global for at least six reasons:

1. *The increased scope of the global management task.* Growth in the size and complexity of global firms made management virtually impossible without a coordinated plan of action detailing what is expected of whom during a given period. The common practice of management by exception is impossible without such a plan.

2. *The increased globalization of firms.* Three aspects of global business make global planning necessary: *(a)* differences among the environmental forces in different countries, *(b)* greater distances, and *(c)* the interrelationships of global operations.

3. *The information explosion.* It has been estimated that the world's stock of knowledge is doubling every 10 years. Without the aid of a formal plan, executives can no longer know all that they must know to solve the complex problems they face. A global planning

[1]Y. Doz and C. K. Prahalad, "Patterns of Strategic Control within Multinational Corporations," *Journal of International Business Studies,* Fall 1984, pp. 55–72.

process provides an ordered means for assembling, analyzing, and distilling the information required for sound decisions.

4. *The increase in global competition.* Because of the rapid increase in global competition, firms must constantly adjust to changing conditions or lose markets to competitors. The increase in global competition also spurs managements to search for methods of increasing efficiency and economy.

5. *The rapid development of technology.* Rapid technological development has shortened product life cycles. Strategic management planning is necessary to ensure the replacement of products that are moving into the maturity stage, with fewer sales and declining profits. Planning gives management greater control of all aspects of new-product introduction.

6. *Strategic management planning breeds managerial confidence.* Like the motorist with a road map, managers with a plan for reaching their objectives know where they are going. Such a plan breeds confidence, because it spells out every step along the way and assigns responsibility for every task. The plan simplifies the managerial job.

A firm in a global industry must maximize its capabilities through a worldwide strategy. Such a strategy necessitates a high degree of centralized decision making in corporate headquarters so as to permit trade-off decisions across subsidiaries.

Among the factors that make for the creation of a global industry are

- Economies of scale in the functional activities of firms in the industry.
- A high level of R&D expenditures on products that require more than one market to recover development costs.
- The presence in the industry of predominantly global firms that expect consistency of products and services across markets.
- The presence of homogeneous product needs across markets, which reduces the requirement of customizing the product for each market. The presence of a small group of global competitors.
- A low level of trade regulation and of regulation regarding foreign direct investment.[2]

Six factors that drive the success of global companies are listed in Exhibit 5.7, Strategy in Action. They address key aspects of globalizing a business's operations and provide a framework within which companies can effectively pursue the global marketplace.

The Global Challenge

Although industries can be characterized as global or multidomestic, few "pure" cases of either type exist. A global firm competing in a global industry must be responsive, to some degree, to local market conditions. Similarly, a global firm competing in a multidomestic industry cannot totally ignore opportunities to utilize intracorporate resources in competitive positioning. Thus, each global firm must decide which of its corporate functional activities should be performed where and what degree of coordination should exist among them.

Location and Coordination of Functional Activities

Typical functional activities of a firm include purchases of input resources, operations, research and development, marketing and sales, and after-sales service. A multinational corporation has a wide range of possible location options for each of these activities and must decide which sets of activities will be performed in how many and which locations. A multinational corporation may have each location perform each activity, or it may center

[2] G. Hamel and C. K. Prahalad, "Managing Strategic Responsibility in the MNC," *Strategic Management Journal,* October–December 1983, pp. 341–51.