Chapter 9: Competing in International Markets

Learning Objectives

After reading this chapter, you should be able to understand and articulate answers to the following questions:

1. What are the main benefits and risks of competing in international markets?
2. What is the "diamond model," and how does it help explain why some firms compete better in international markets than others?
3. How does the CAGE framework help a firm predict its degree of success in doing business in another country?
4. What are the four global strategies that firms can adopt, and what are the two pressures that define these strategies?
5. What methods of entry are available to firms that seek to compete in international markets?

9.1 Introduction

International strategy is the third and final type of strategy presented in this textbook. The first, generic business-level/competitive strategy, is how companies directly compete with rivals on their products and services. Corporate strategy is how a firm might diversify to compete in other industries or expand geographically to reduce risk and grow profits. In international strategy, a firm may desire to expand by entering into new foreign markets or to lower its costs. There are advantages and opportunities when going international, but it is not without risks. There are several tools that firms use to help them assess their potential success when their strategic management process points them abroad. Firms will need to determine which one of four international strategies will work best and which method to enter another country. Some US companies have found great success going international, while others have struggled or failed.

9.2 Advantages and Disadvantages of Competing in International Markets

Kia Picks Up Speed

On June 2, 2011, South Korean automaker Kia announced plans for a major expansion of its American production facility. Capacity at Kia Motors Manufacturing Georgia Inc. (KMMG) was slated to expand 20% from 300,000 to 360,000 vehicles per year. In addition to the crossover utility vehicle Sorento, the plant would begin making a sedan named the Optima in September 2011. The expansion of the plant was estimated to cost $100 million and was expected to create 1,000 new jobs (Sands, 2011).

Figure 9.1: Kia is enjoying accelerated growth within the global automobile industry.

This ambitious growth was made possible by Kia's superb performance in the US market. KMMG had started building vehicles less than two years earlier after being constructed for a cost of $1 billion. In 2010, yearly sales in the United States climbed above 350,000 vehicles. Kia's overall share of the US market increased in 2010 for the sixteenth consecutive year. In May 2011, Kia sold more than 48,000 cars and trucks in the United States, an increase of more than 53% from May 2010 sales levels. The Optima led the way with a whopping 210% increase in sales.

Kia was not the only beneficiary of its success. KMMG's location of West Point, Georgia, had been economically devastated when its homegrown textile company, WestPoint Home, shut down its local factories to take advantage of lower labor prices overseas. Following a fierce competition with towns in Mississippi, Kentucky, and other states, West Point was selected in 2006 as the site of Kia's first US manufacturing facility. To win the plant, state and local authorities offered Kia more than $400 million worth of incentives, including tax breaks, free land, and infrastructure creation. This kind of governmental inducement has become commonplace when states lure new businesses to a region. This practice is also an example of "corporate welfare."

Georgia's return on this investment included two thousand new jobs at the plant as well as hundreds of jobs at suppliers that set up shop to support KMMG. The neighboring state of Alabama benefited from KMMG's success too. As of June 2011, nearly sixty companies spread across twenty-three Alabama counties supplied parts or services to KMMG (Kent, 2011).

Figure 9.2: Workers in Georgia build Cadenzass for South Korea–based Kia.

The name "Kia" means to arise or come up out of Asia (Kia, n.d.). This name is very appropriate; Kia rose from humble beginnings as a maker of bicycle parts in 1944 to become a global player in the automobile industry. As of 2011, Kia was producing more than 2.1 million vehicles per year in eight countries. Kias were sold in 172 countries. Kia employed more than 44,000 people and enjoyed annual revenues in excess of $20 billion. Fellow South Korean automaker Hyundai owned just over 33% of Kia, and the two firms strengthened each other through collaboration. When taking all of these facts into consideration, Kia's slogan—"The Power to Surprise"—had to make its rivals wonder what surprises the Korean upstart might have in store for them next.

As Kia's experience illustrates, international business is a huge segment of the world's economic activity. Amazingly, current projections suggest that, within a few years, the total dollar value of trade across national borders will be greater than the total dollar value of trade within all of the world's countries combined. One driver of the rapid growth of internal business over the past two decades has been the opening up of large economies such as China and Russia that had been mostly closed off to outside investors.

International strategy is determining how to do business outside the borders of a firm's home country. International business has opened up significantly in the last few decades. This has been due to lower trade barriers, improved communications, more efficient shipping via ship and airplane, and the internet. Many US companies have shifted their manufacturing and supply chain activities abroad, where labor is cheaper and overall costs are reduced, even with the additional costs of shipping. The COVID-19 pandemic of 2020 illustrated some issues that emerge when an economy, such as with the US, becomes dependent on other countries for the materials it uses for its final products. During the pandemic, the capacity for global supply chains to meet the sharp increase in demand for paper goods, cleaning supplies, as well as for medications and other medical equipment and supplies, was immediately strained.

International strategy for a firm can be somewhat minimal, such as procuring needed supply chain resources for manufacturing a product in the home country, to an expanded role, like exporting products for sale in other countries, to full manufacturing subsidiaries such as the Kia example in the US. There are multiple reasons why a firm would go international, and also multiple advantages and disadvantages.

The domestication of the camel by Arabian travelers fueled two early examples of international trade: spices and silk. Today, camels have been replaced by airplanes, trains, and ships, and international trade is more alluring than ever. Here are three key reasons why executives are enticed to enter new markets.

Table 9.1 Why Compete in New Markets?

Access to new customers	China's population is roughly four times as large as that of the United States. While political, cultural, and economic differences add danger to trade with China, the immense size of the Chinese market appeals to American firms.
Lowering costs	Access to cheaper raw materials and labor have led to considerable outsourcing and offshoring. Call centers in India have become so sophisticated that many Indian customer service representatives take extensive language training to learn regional US dialects.
Diversification of business risk	Business risk refers to the risk of an operation failing. Competing in multiple markets allows this risk to be spread out among many economies and customers. Coca-Cola, for example, has a presence in over 200 markets worldwide.

The United States enjoys the world's largest economy. As an illustration of the power of the American economy, consider that in 2018, the economy of just one state—California—was the fifth largest in the world. If it were a country, it would rank between Germany and the United Kingdom (CBS News, 2018). The size of the US economy has led American commerce to be very much intertwined with international markets. In fact, it is fair to say that every business is affected by international markets to some degree. Tiny businesses such as individual convenience stores and clothing boutiques sell products that are imported from abroad. Meanwhile, corporate goliaths such as General Motors (GM), Coca-Cola, and Microsoft conduct a great volume of business overseas.

Access to New Customers

Perhaps the most obvious reason to compete in international markets is gaining access to new customers. Although the United States enjoys the largest economy in the world, it accounts for only about 5% of the world's population. Selling goods and services to the other 95% of people on the planet can be very appealing, especially for companies whose industry within their home market is saturated (Table 9.1).

Few companies have a stronger "All-American" identity than McDonald's. Yet McDonald's is increasingly reliant on sales outside the United States. In 2006, the United States accounted for 34% of McDonald's revenue, while Europe accounted for 32% and 14% was generated across Asia, the Middle East, and Africa. By 2011, Europe was McDonald's biggest source of revenue (40%), the US share had fallen to 32%, and the collective contribution of Asia, the Middle East, and Africa had jumped to 23%. By 2019, McDonald's US percent of total revenue had grown to 41% (Statista, 2019). With less than half of its sales being generated in its home country, McDonald's is truly a global powerhouse.

Figure 9.3: Levi's jeans are appreciated by customers worldwide, as shown by this balloon featured at the Putrajaya International Hot Air Balloon Fiesta held in Malaysia.

China and India have been attractive markets to US firms. The countries are the two most populous in the world. Both nations have growing middle classes, which means they have been building infrastructures, like education and transportation systems, that support increased purchasing power. In other words, individuals in these countries can buy goods and services that are not merely necessities of life. This trend has created tremendous opportunities for some firms. In 2019, for example, GM sold more vehicles in China than it sold in the United States (3.1 million vs. 2.9 million). This gap has continued from at least 2010. (Reuters, 2020).

Lowering Costs

Many firms that compete in international markets hope to gain cost advantages. If a firm can increase its sales volume by entering a new country, for example, it may attain **economies of scale** that lower its per unit production costs. Going international also has implications for dealing with suppliers. The growth of overseas expansion leads many businesses to purchase supplies in greater numbers. This can provide a firm with stronger leverage when negotiating prices with its suppliers.

Offshoring has become a popular yet controversial means for trying to reduce costs. Offshoring involves relocating a business activity to another country. Many American companies have closed down operations at home in favor of creating new operations in countries such as China and India that offer cheaper labor. While offshoring can reduce a firm's costs of doing business, the job losses in the firm's home country can devastate local communities. For example, West Point, Georgia, lost approximately 16,000 jobs in the 1990s and 2000s as local textile factories were shut down in favor of offshoring (Copeland, 2010). Fortunately for the town, Kia's decision to locate its first US factory in West Point has improved the economy in the past few years. In another example, Fortune Brands saved $45 million a year by relocating several factories to Mexico, but the employee count in just one of the affected US plants dropped from 1,160 to 350.

A growing number of US companies are finding that offshoring is not providing the benefits they had expected. This has led to a new phenomenon known as **reshoring**, whereby jobs that had been sent overseas are returning home. In some cases, the quality provided by workers overseas is not good enough. Carbonite, a seller of computer backup services, found that its call center in Boston was providing much stronger customer satisfaction than its call center in India. The Boston operation's higher rating was attained even though it handled the more challenging customer complaints. As a result, Carbonite shifted 250 call center jobs back to the United States.

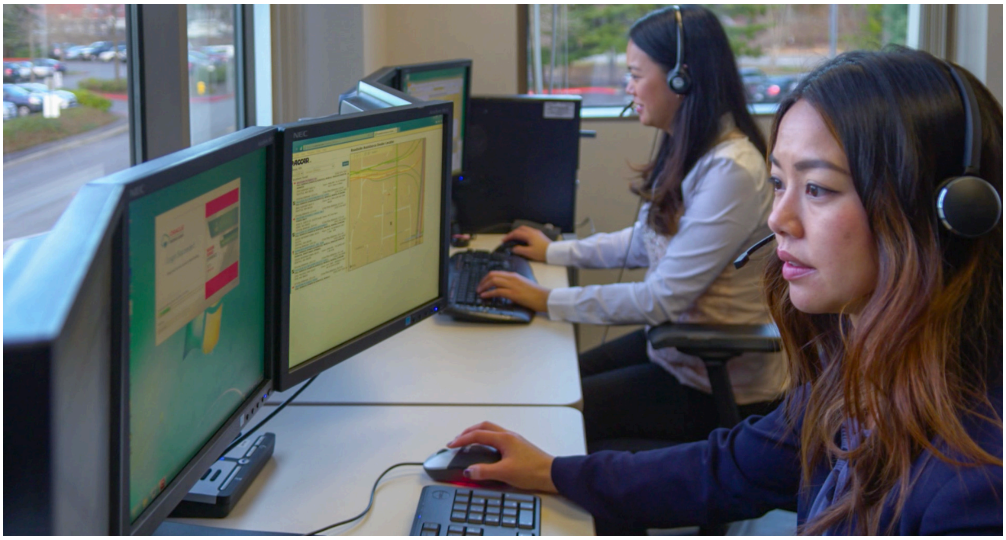

Figure 9.4: Concerns about customer service are leading some American firms to shift their call centers back to the United States.

In other cases, the expected cost savings have not materialized. NCR had been making ATMs and self-service checkout systems in China, Hungary, and Brazil. These machines can weigh more than a ton, and NCR found that shipping them from overseas plants back to the United States was extremely expensive. NCR hired 500 workers to start making the ATMs and checkout systems at a plant in Columbus, Georgia, adding 370 more jobs (Isidore, 2011). Similarly, Apple, General Motors, Boeing, and Ford had brought back thousands of jobs each to the US from abroad by 2019 (Monroe Engineering, 2018).

Diversification of Business Risk

A familiar cliché warns "don't put all of your eggs in one basket." Applied to business, this cliché suggests that it is dangerous for a firm to operate in only one country. Business risk refers to the potential that an operation might fail. If a firm is completely dependent on one country, negative events in that country could ruin the firm. Just like spreading one's eggs into multiple baskets reduces the chances that all eggs will be broken, business risk is reduced when a firm is involved in multiple countries.

Consider, for example, natural disasters such as the earthquakes and tsunami that hit Japan in 2011. If Japanese automakers such as Toyota, Nissan, and Honda sold cars only in their home country, the financial consequences could have been grave. Because these firms operate in many countries, however, they were protected from being ruined by events in Japan. In other words, these firms diversified their business risk by not being overly dependent on their Japanese operations.

American cigarette companies such as Philip Morris and R. J. Reynolds are challenged by trends within the United States and Europe. Tobacco use in these areas is declining as more laws are passed that ban smoking in public areas and in restaurants. In response, cigarette makers are attempting to increase their operations within countries where smoking remains popular to remain profitable over time.

Figure 9.5: Firms can reduce business risk by competing in a variety of international markets. For example, the ampm convenience store chain has locations in the United States, Mexico, Brazil, and Japan.

For example, Philip Morris spent $5.2 billion to purchase a controlling interest in Indonesian cigarette maker Sampoerna. This was the biggest acquisition ever in Indonesia by a foreign company. Tapping into Indonesia's population of approximately 230 million people was attractive to Philip Morris in part because nearly two-thirds of men are smokers, and smoking among women is on the rise. At the time, Indonesia was the fifth-largest tobacco market in the world, trailing only China, the United States, Russia, and Japan. To appeal to local preferences for cigarettes flavored with cloves, Philip Morris introduced a variety of its signature Marlboro brand called Marlboro Mix 9 that includes cloves in its formulation (The Two Malcontents, 2007).

The use of **PESTEL** can be a valuable tool in assessing the risk for a firm considering international diversification. Analyzing the industry within the target country could provide valuable insights on whether to enter that market or not. For example, if Apple were to consider shifting some of its product manufacturing to India, what do the PESTEL forces reveal for the Indian IT industry?

Table 9.2 PESTEL Analysis of the IT Industry in India

Political	Moderate, positive & negative: Stable government, democracy, international companies highly regulated
Economical	Strong, positive: Low cost labor, IT has strong growth
Socio-cultural	Strong, positive: Many speak English, strong STEM education
Technological	Strong, positive: Strong growth
Ecological	Weak
Legal	Moderate, negative: Highly regulated

In conclusion, a PESTEL analysis reveals that overall it would be a positive move for Apple to do manufacturing in India, but will need to comply with many laws and regulations.

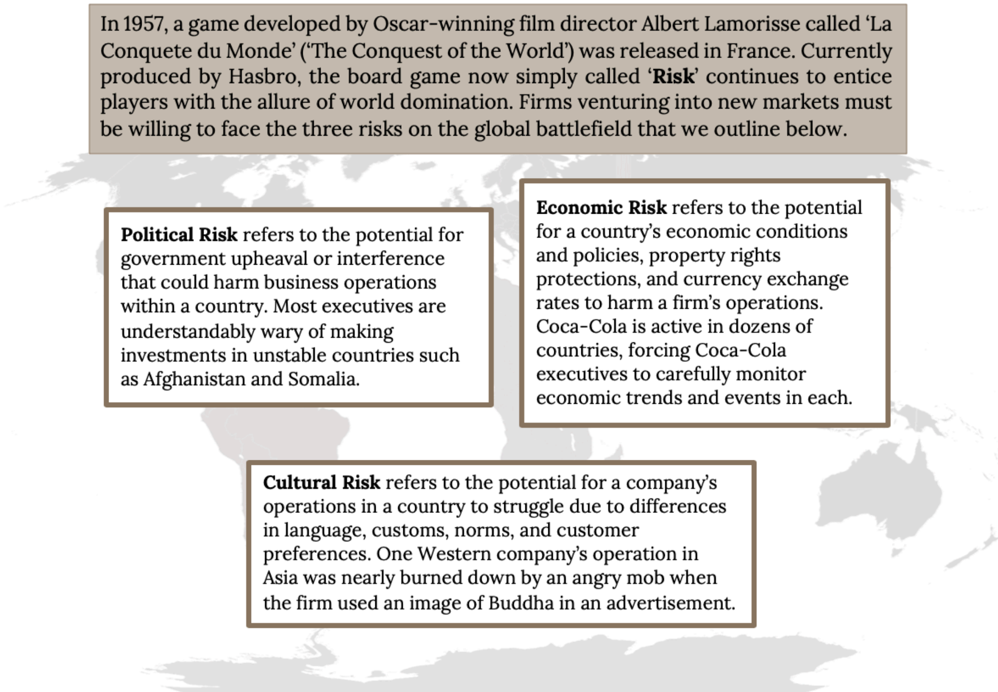

Figure 9.6: Entering New Markets: Worth the Risk?

Political Risk

Although competing in international markets offers important potential benefits, such as access to new customers, the opportunity to lower costs, and the diversification of business risk, going overseas also poses daunting challenges. **Political risk** refers to the potential for government upheaval or interference with business to harm an operation within a country (Figure 9.1). For example, the term "Arab Spring" has been used to refer to a series of uprisings in 2011 within countries such as Tunisia, Egypt, Libya, Bahrain, Syria, and Yemen. Unstable governments associated with such demonstrations and uprisings make it difficult for firms to plan for the future. Over time, a government could become increasingly hostile to foreign businesses by imposing new taxes and new regulations. In extreme cases, a firm's assets in a country are seized by the national government. This process is called nationalization. In recent years, for example, Venezuela has nationalized foreign-controlled operations in the oil, cement, steel, and glass industries. US oil companies were expelled from the country.

Countries with the highest levels of political risk tend to be those whose governments are so unstable that few foreign companies are willing to enter them because of the potential for physical violence and harm to life or property. High levels of political risk are also present, however, in several of the world's important emerging economies, including India, the Philippines, and Indonesia. This creates a dilemma for firms in that these risky settings also offer enormous growth opportunities. Firms can choose to concentrate their efforts in countries such as Canada, Australia, South Korea, and Japan that have very low levels of political risk, but opportunities in such settings are often more modest (Kostigen, 2011).

Economic Risk

Economic risk refers to the potential for a country's economic conditions and policies, property rights protections, and currency exchange rates to harm a firm's operations within a country. Executives who lead companies that do business in many different countries have to take stock of these various dimensions and try to anticipate how the dimensions will affect their companies. Because economies are unpredictable, economic risk presents executives with tremendous challenges.

Figure 9.7: President Hugo Chavez of Venezuela nationalized the oil industry, expelling US oil companies.

Figure 9.8: Economic risk involves many complex and daunting elements.

Consider, for example, Kia's operations in Europe., Kia reported increased sales in ten European countries relative to the prior year. The firm enjoyed a 62% year-to-year increase in Slovakia, 58% in Austria, 50% in Gibraltar, 49% in Sweden, 43% in Poland, 24% in Germany, 21% in the United Kingdom, 13% in the Czech Republic, 6% in Belgium, and 3% in Italy (Kia, 2020). As Kia's executives planned for the future, they needed to wonder how economic conditions would influence Kia's future performance in Europe. If inflation and interest rates were to increase in a particular country, this would make it more difficult for consumers to purchase new Kias. If currency exchange rates were to change such that the euro became weaker relative to the South Korean won, this would make a Kia more expensive for European buyers.

Cultural Risk

Cultural risk refers to the potential for a company's operations in a country to struggle because of differences in language, customs, norms, and customer preferences (Table 9.2). The history of business is full of colorful examples of cultural differences undermining companies. For example, a laundry detergent company was surprised by its poor sales in the Middle East. Executives believed that their product was being skillfully promoted using print advertisements that showed dirty clothing on the left, a box of detergent in the middle, and clean clothing on the right. A simple and effective message, right? Not exactly. Unlike English and other Western languages, the languages used in the Middle East, such as Hebrew and Arabic, involve reading from right to left. To consumers, the implication of the detergent ads was that the product could be used to take clean clothes and make them dirty. Not surprisingly, few boxes of the detergent were sold before this cultural blunder was discovered.

The phrase "When in Rome, do as the Romans do" is used to encourage travelers to embrace local customs. An important part of fitting in is avoiding behaviors that locals consider offensive. Below we illustrate a number of activities that would go largely unnoticed in the United States but could raise concerns in other countries.

Table 9.3 Cultural Risk: When in Rome

Examples of Cultural Risk
If you want to signal "Check please!" to catch the attention of your garçon in France and Belgium, remember that snapping your fingers is vulgar there.
Provocative dress is embraced by many Americans, but many people in Muslim countries consider a woman's clothing to be inappropriate if it reveals anything besides the face and hands.
Do you pride yourself on your punctuality? You may be wasting your time in Latin American countries, where the locals tend to be about 20 minutes behind schedule.
Do not eat with your left hand in India or Malaysia. That hand is associated with unclean activities reserved for the bathroom.
In many Asian and Arabian countries, showing the sole of your shoe is considered rude.
If everything is OK when you're in Brazil, avoid making the "OK" hand signal. It's the equivalent to giving someone the middle finger.
Do not clean your plate in China. Leaving food on the plate indicates the host was so generous that the meal could not be finished.
In Japan, direct eye contact is viewed as impolite.

A refrigerator manufacturer experienced poor sales in the Middle East because of another cultural difference. The firm used a photo of an open refrigerator in its print ads to demonstrate the large amount of storage offered by the appliance. Unfortunately, the photo prominently featured pork, a type of meat that is not eaten by the Jews and Muslims who make up most of the area's population (Ricks, 1993). To get a sense of consumers' reactions, imagine if you saw a refrigerator ad that showed meat from a horse or a dog. You would likely be disgusted. In some parts of the world, however, horse and dog meat are accepted parts of diets. Firms must take cultural differences such as these into account when competing in international markets.

Cultural differences can cause problems even when the cultures involved are very similar and share the same language. RecycleBank is an American firm that specializes in creating programs that reward people for recycling, similar to airlines' frequent-flyer programs. When RecycleBank expanded its operations into the United Kingdom, executives at RecycleBank became offended when the British press referred to RecycleBank's rewards program as a "scheme." Their concern was unwarranted, however. The word scheme implies sneakiness when used in the United States, but a scheme simply means a service in the United Kingdom (Maltby, 2010). Differences in the meaning of English words between the United States and the United Kingdom are also vexing (Table 9.4).

Cultural differences rooted in language—even across English-speaking countries—can affect how firms do business internationally. Below we provide a few examples.

Table 9.4 Watch Your Language

Cultural Differences in Language
Book and movie titles are often changed in different markets to appeal to different cultural sensibilities. For example, British author J.K. Rowling's Harry Potter and the Philosopher's Stone was changed to Harry Potter and the Sorcerer's Stone in the United States because of the belief that American children would find a philosopher to be boring.
Moms in the states can be seen walking with strollers in their neighborhoods, while "mums" in Ireland and the United Kingdom keep their children moving in a buggy.
In India, you are more likely to hear "no problem" than "no" as Indian nationals avoid the disappointment associated with using the word no.
The area of a car called a trunk in America is known as the boot in England.
Wondering what it means when a British friend asks, "What's under your bonnet?" Open the hood of your car to offer an answer.
While Americans look for a flashlight when power goes out, a torch is the preferred term for those outside of North America.
Urban legend says that the Chevrolet Nova did not do well in Spanish speaking countries because the name translates as "no go." The truth is that the car sold well in both Mexico and Venezuela.

Key Takeaway

- Competing in international markets involves important opportunities and daunting threats. The opportunities include access to new customers, lowering costs, and diversification of business risk. The threats include political risk, economic risk, and cultural risk.

Exercises

1. Is offshoring ethical or unethical? Why?
2. Do you expect reshoring to become more popular in the years ahead? Why or why not?
3. Have you ever seen an advertisement that was culturally offensive? Why do you think that companies are sometimes slow to realize that their ads will offend people?

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Figure 9.7: Agência Brasil (2008). CC BY 3.0 Brazil. Retrieved from: https://commons.wikimedia.org/wiki/File:Hugo_Chavez_in_Guatemala.jpg.

Figure 9.8: Quapan. "German Banks 'Can Afford' a Greek Debt Default." CC BY 2.0. Retrieved from https://www.flickr.com/photos/hinkelstone/6309941378/.

9.3 CAGE Framework

Doing business abroad is fraught with peril. Even Target failed when it opened stores in Canada—a move that one would think was easy. A firm must assess the risks and the likelihood of success before taking the leap. One way to do this is to analyze the political, economic, and cultural risks discussed earlier in this chapter. Another tool to assist in this evaluation is the CAGE framework.

The CAGE framework (Mariadoss, 2017) helps a firm gauge the distance that the target country is from the firm's home country on four dimensions. The greater the distance or difference, the more risk exists and the less opportunity there is for success.

The four CAGE dimensions are:

- Cultural Distance
- Administrative Distance
- Geographic Distance
- Economic Distance

Cultural Distance: This refers to the differences of cultures between the target and home countries. The history of relationships between nations provides one source of explanation for the closeness (similarity) or distance (difference) between cultures. For instance, many countries suffered under the domination of imperial rule during colonial times with effects that are evident in their contemporary culture and influencing national relationships. For example, as a former colony of Great Britain, there is a smaller cultural distance between the US and the United Kingdom than there is between the US and Spain. However, this is not always the case. Western European countries have a significant cultural distance with many Asian countries despite having colonized many of those same territories. Therefore, history provides a partial insight into cultural distance.

Societal customs and values also play a key role in cultural distance. Language differences also increase or decrease cultural distance. At first glance, it would appear that the US and India would have a large cultural distance, but this is reduced because much of business in India is conducted in English, and both countries were colonies of Great Britain.

Administrative Distance: The legal and political systems of the home and target countries determine the administrative distance between the two. In countries where the political systems are different, for example, democracy versus communism, there is a greater distance and more uncertainty. Different laws between countries can make compliance and doing business more difficult. For example, in some countries, laws governing contract compliance are not enforced. In some nations if a buyer fails to make payment for purchases, the seller can sue, but it may take years before a court will even hear the case. Also, labor laws can be quite different among nations. In the Dominican Republic, for instance, companies are required to pay employees a thirteenth month of salary at the end of the year, as a bonus. Alternatively, some nations protect the civil rights of people who fall within protected categories in the US (e.g., age, race, sex, class, gender, sexual orientation, etc.), but other nations may not. This raises particularly tricky questions for firms who must abide by US laws, but seek to expand abroad,

Geographic Distance: The literal physical distance between the home and target country are a key consideration of this dimension. The more miles the countries are apart, the longer and more costly it is to go there or to ship from one to the other. But mileage is not the only factor. The ease of communication between countries is another. Advances in telephone and internet communications have made this almost a non-issue in most countries. However, when two countries are twelve time zones apart, like the US and China, communication can be hampered when work schedules are twelve hours out of sync. Geographic distance can also be affected by the infrastructure of a country in other ways other than communication and internet capabilities. For example, Haiti is physically close to the US, but its lack of adequate port facilities make it a poor target for outsourcing manufacturing.

Economic Distance: International business between two countries is also impacted by the differences in their economic factors. The greater the differences in the two economies, the more difficult it is to be successful. One way to measure the difference is by GDP per capita. Countries with a similar GDP per capita have a greater opportunity for success. If the purchasing power and disposable income of the target country are quite different from the home country, working in the target country is more challenging.

Suppose Chipotle believes there are great opportunities if they go international. Executives have narrowed the countries down to two—Canada and Spain. Canada made the list because they are close and more like the US. But Spain has 10 million more inhabitants, is not spread out like Canada is, and Spaniards should have a great attraction to Chipotle's menu, since it's Mexican cuisine. The CAGE framework can be used to help make a decision. The four dimensions for each country are measured on a 10 point scale, with the higher numbers indicating greater distance. Therefore, the country with the lower score is the better choice. Table 9.5 illustrates the process.

Table 9.5 Using the CAGE Framework: Canada vs Spain for Chipotle

	C Cultural	**A** Administrative	**G** Geographic	**E** Economic	**Total**
Canada	**3** Oh, there is the French speaking part of Canada	**2** Parliamentarian with Prime Minister vs US	**2** Very close, but cities very spread out	**2** About the same except for currency	**9**
Spain	**7** Language difference, and they don't eat much Mexican food	**5** Member of EU, similar to US, some laws different	**5** Easy 6 hour plane flight, 6 hour time difference.	**6** US GDP per capita twice Spain's.	**23**

As can be seen from the CAGE scores, the Chipotle executives' hunches about Spain proved incorrect, and Canada is the best location to first go international.

Section Video

CAGE *Framework for International Trade-Global Matters* [02:24]

The video for this lesson discusses the CAGE framework and how it can be used to evaluate international trade opportunities.

You can view this video here: https://youtu.be/7FpUJaG7uMk.

Key Takeaway

- Success with implementing an international strategy starts with selecting the correct country to enter. Using the CAGE framework allows a firm to compare target countries to help make this critical decision. Understanding the distance between the home country and the target country as it relates to differences in culture, administrative functions, geographic barriers, and economic disparities will assist the firm in making the best decision.

Exercises

1. Tesla wants to explore going into Europe or South America, and has narrowed down the countries to Germany or Chile. Use the CAGE framework to decide which would be the better choice.
2. Divide up into groups of 4 or 8 and discuss some of the cultural differences that exist across countries that cultural distance shows should be taken into consideration. Report out.

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Video Credits

Carlson School of Management. (2015, March 12). *Pankaj Ghemawat: CAGE framework for international trade – global matters* [Video]. YouTube. https://youtu.be/7FpUJaG7uMk.

9.4 Types of International Strategies

A firm that has operations in more than one country is known as a **multinational corporation** (MNC). The largest MNCs are major players within the international arena. Walmart's annual worldwide sales, for example, are larger than the dollar value of the entire economies of Austria, Norway, and Saudi Arabia. Although Walmart tends to be viewed as an American retailer, the firm earns 35% of its revenues outside the United States. Walmart owns significant numbers of stores in Mexico, Central America, Brazil, Japan, the United Kingdom, Canada, Chile, Botswana, and Argentina. Walmart also participates in joint ventures in China and India. Even more modestly sized MNCs are still very powerful. If Kia were a country, its current sales level of approximately $21 billion would place it in the top 100 among the more than 180 nations in the world.

Multinationals such as Kia and Walmart must choose an international strategy to guide their efforts in various countries. There are four main international strategies available:

1. International
2. Multi-domestic
3. Global
4. Transnational

(Figure 9.2). Each strategy involves a different approach to trying to be sensitive to (1) costs and efficiencies on one hand and trying to be responsive to (2) variation in customer preferences and market conditions across nations. Responding or not responding to these two pressures of cost and local cultural conditions determines which of the four types of international strategies will be pursued.

Figure 9.9: Four International Strategies

International Strategy

Firms pursuing an international strategy are neither concerned about costs nor adapting to the local cultural conditions. They attempt to sell their products internationally with little to no change. When Harley Davidson sells motorcycles abroad, they do not need to lower their prices or adapt the bike to local motorcycle standards. People in other countries buy a Harley particularly because it is different from the local motorcycles. Buyers want the American look and the sound and power of a Harley, and will pay for that differentiation. Belgium chocolate exporters do not lower their price when exporting to the American market to compete with Hershey's, nor do they adapt their product to American tastes. They use an international strategy. Starbucks and Rolex watches are other examples of firms pursuing the international strategy.

Multi-Domestic Strategy

A firm using a multi-domestic strategy does not focus on cost or efficiency but emphasizes responsiveness to local requirements within each of its markets. Rather than trying to force all of its American-made shows on viewers around the globe, Netflix customizes the programming that is shown on its channels within dozens of countries, including New Zealand, Portugal, Pakistan, and India. Similarly, food company H. J. Heinz adapts its products to match local preferences. Because some Indians will not eat garlic and onion, for example, Heinz offers them a version of its signature ketchup that does not include these two ingredients. Outback Steakhouse uses the multi-domestic strategy in the multiple countries where it operates, adapting to local eating preferences but not lowering prices significantly.

Figure 9.10: Baked beans flavored with curry? This H. J. Heinz product is very popular in the United Kingdom.

Global Strategy

A firm using a global strategy sacrifices responsiveness to local requirements within each of its markets in favor of emphasizing lower costs and better efficiency. This strategy is the complete opposite of a multi-domestic strategy. Some minor modifications to products and services may be made in various markets, but a global strategy stresses the need to gain low costs and economies of scale by offering essentially the same products or services in each market.

Microsoft, for example, offers the same software programs around the world but adjusts the programs to match local languages. Similarly, consumer goods maker Procter & Gamble attempts to gain efficiency by creating global brands whenever possible. Global strategies also can be very effective for firms whose product or service is largely hidden from the customer's view, such as silicon chip maker Intel. Lenovo also uses this strategy. For such firms, variance in local preferences is not very important, but pricing is.

Transnational Strategy

A firm using a transnational strategy seeks a middle ground between a multi-domestic strategy and a global strategy. Such a firm tries to balance the desire for lower costs and efficiency with the need to adjust to local preferences within various countries. For example, large fast-food chains such as McDonald's and Kentucky Fried Chicken (KFC) rely on the same brand names and the same core menu items around the world. These firms make some concessions to local tastes too. In France, for example, wine can be purchased at McDonald's. This approach makes sense for McDonald's because wine is a central element of French diets. In Saudi Arabia, McDonalds serves a McArabia Chicken sandwich, and its breakfast menu features no pork products like ham, bacon, or sausage.

Section Video

Global Strategies [02:45]

The video for this lesson discusses global strategy options.

You can view this video here: https://youtu.be/83rBbT5Qq_E.

Key Takeaway

- Multinational corporations choose from among four basic international strategies: (1) international (2) multi-domestic, (3) global, and (4) transnational. These strategies vary depending on two pressures; 1) on emphasizing low cost and efficiency and 2) responding to the local culture and needs.

Exercises

1. Which of the four international strategies is Kia using? Is this the best strategy for Kia to be using?
2. Identify examples of companies using each of the four international strategies other than those described above. Which company do you think is best positioned to compete in international markets?

Image Credits

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Figure 9.10: AtelierJoly. "Curried Beans." CC BY-SA 3.0. Cropped. Retrieved from https://commons.wikimedia.org/wiki/File:Curry_Beanz.jpg.

Video Credits

pb venkat. (2015, May 14). *Global strategies* [Video]. YouTube. https://youtu.be/83rBbT5Qq_E.

9.5 Drivers of Success and Failure When Competing in International Markets

The title of a book written by newspaper columnist Thomas Friedman attracted a great deal of attention when the book was released in 2005. In *The World Is Flat: A Brief History of the 21st Century*, Friedman argued that technological advances and increased interconnectedness is leveling the competitive playing field between developed and emerging countries. This means that companies exist in a "flat world" because economies across the globe are converging on a single integrated global system (Friedman, 2005). For executives, a key implication is that a firm being based in a particular country is ceasing to be an advantage or disadvantage.

While Friedman's notion of business becoming a flat world is flashy and attention grabbing, it does not match reality. Research studies conducted since 2005 have found that some firms enjoy advantages based on their country of origin while others suffer disadvantages. A powerful framework for understanding how likely it is that firms based in a particular country will be successful when competing in international markets was provided by Professor Michael Porter of the Harvard Business School (Porter, 1990). The framework is formally known as "the determinants of national advantage," but it is often referred to more simply as "the diamond model" because of its shape (Table 9.6).

Diamonds may be a country's best friend. Around half of the world's diamonds are mined in South Africa, giving that country a unique advantage in the global diamond industry. Porter's Determinants of National Advantage (often referred to as the diamond model) includes four key dimensions that help explain why firms located in certain countries are more successful than others in particular industries.

Table 9.6 Porter's Diamond Model of National Advantage

Strategy, Structure, and Rivalry	The United States has an overall trade deficit, but it enjoys a trade surplus within the service sector. Fierce domestic competition in industries such as hotels and restaurants has helped make American firms such as Marriott and Subway important players on the world stage.
Factor Conditions	The inputs present in a country shape a firm's global competitiveness. The rapid growth of Chinese manufacturers has been fueled by the availability of cheap labor.
Demand Conditions	Fussy domestic customers help firms prepare for the global arena. Japanese firms must create excellent goods to meet Japanese consumers' high expectations about quality, aesthetics, and reliability.
Related and Supporting Industries	Firms benefit when their domestic suppliers and other complementary industries are developed and helpful. Italy's fashion industry is enhanced by the abundance of fine Italian leather and well-known designers.

According to the model, the ability of the firms in an industry whose origin is in a particular country (e.g., South Korean automakers or Italian shoemakers) to be successful in the international arena is shaped by four factors:

1. Their home country's demand conditions
2. Their home country's factor conditions
3. Related and supporting industries within their home country
4. Strategy, structure, and rivalry among their domestic competitors

Demand Conditions

Within the diamond model, demand conditions refer to the nature of domestic customers (Table 9.7). It is tempting to believe that firms benefit when their domestic customers are perfectly willing to purchase inferior products. This would be a faulty belief! Instead, firms benefit when their domestic customers have high expectations.

Figure 9.11: Japanese firms must deliver very high quality to meet the expectations of Japanese consumers.

Japanese consumers are known for insisting on very high levels of quality, aesthetics, and reliability. Japanese automakers such as Honda, Toyota, and Nissan reap rewards from this situation. These firms have to work hard to satisfy their domestic buyers. Living up to lofty quality standards at home prepares these firms to offer high-quality products when competing in international markets. In contrast, French car buyers do not stand out as particularly fussy. It is probably not a coincidence that French automakers Renault and Peugeot have struggled to gain traction within the global auto industry.

Within the diamond model, demand conditions refer to the nature of domestic customers. Below we provide examples from the worldwide auto industry that illustrate how domestic customers influence firms' ability to compete in the global arena.

Table 9.7 Demand Conditions

Demand Condition Examples
Japanese consumers insist on very high levels of quality, aesthetics, and reliability. This forces Honda, Toyota, and Nissan to rise to a difficult challenge as well as preparing them to dominate internationally.
Because French car buyers are not particularly picky, Renault and Peugeot have not been forced to excel in their home market. Not surprisingly, they have struggled to gain traction within the global auto industry.
Germans place value on the concept of fahrvergnügen, which means "driving pleasure." Customers around the globe experience driving pleasure when purchasing cars from BMW, Mercedes-Benz, Porsche, and Volkswagen.
The Italian fascination with styling is evident in luxury car brands such as Alfa Romeo, Ferrari, Lamborghini, and Maserati.
To many Americans, bigger is better. This attitude is captured in the large SUVs like the Suburban. When gas prices go down, sales of these hunkers go up.

Demand conditions also help to explain why German automakers such as Porsche, Mercedes-Benz, and BMW create excellent luxury and high-performance vehicles. German consumers value superb engineering. While a car is simply a means of transportation in some cultures, Germans place value on the concept of fahrvergnügen, which means "driving pleasure." Meanwhile, demand for fast cars is high in Germany because the country has built nearly eight thousand miles of superhighways known as autobahns. No speed limits for cars are enforced on more than half of the eight thousand miles. Many Germans enjoy driving at 150 miles per hour or more, and German automakers must build cars capable of safely reaching and maintaining such speeds. When these companies compete in the international arena, the engineering and performance of their vehicles stand out.

Factor Conditions

Factor conditions refer to the nature of raw material and other inputs that firms need to create goods and services (Table 9.8). Examples include land, labor, capital markets, and infrastructure. Firms benefit when they have good access to factor conditions and face challenges when they do not. Companies based in the United States, for example, are able to draw on plentiful natural resources, a skilled labor force, highly developed transportation systems, and sophisticated capital markets to be successful. The dramatic growth of Chinese manufacturers in recent years has been fueled in part by the availability of cheap labor.

The factor conditions in a country serve as the basic building blocks of doing business within the country. Below are examples of how important factor conditions have provided competitive advantages for firms based in certain different countries.

Table 9.8 Factor Conditions

Land	Russia has the greatest land mass of any country in the world and it enjoys vast oil deposits. This abundance of natural resources has helped Russia's petroleum industry become one of the largest in the world.
Labor	India is the seventh largest country in terms of land mass, but its population size is second only to China. Because India graduates more English speakers annually than the United States, it should come as no surprise that Indian firms have gained ground in the international arena within industries that rely on engineering and computer skills.
Capital	The capital market in the United States is one of the largest and most sophisticated in the world. This has helped American companies fund expansion and innovation over time, making them better prepared for international competition.
Entrepreneurial Ability	Entrepreneurial ability creates national wealth when entrepreneurs develop new innovations that support key industries. Denmark's low start-up costs and high research and development spending have fueled success in industries such as pharmaceuticals and medical equipment.

In some cases, overcoming disadvantages in factor conditions leads companies to develop unique skills. Japan is a relatively small island nation with little room to spare. This situation has led Japanese firms to be pioneers in the efficient use of warehouse space through systems such as just-in-time inventory management (JIT). Rather than storing large amounts of parts and material, JIT management conserves space—and lowers costs—by requiring inputs to a production process to arrive at the moment they are needed. Their use of JIT management has given Japanese manufacturers an advantage when they compete in international markets.

Figure 9.12: American furniture makers benefit from the abundance of high-quality lumber in the United States.

Related and Supporting Industries

The Beatles' legendary songwriting team of Lennon and McCartney once wrote that they got by "with a little help from my friends." In Porter's diamond model, the presence of strong friends in the form of related and supporting industries is one of the keys to national advantage. We provide examples of American industries that excel internationally due in part to help from supporting industries.

Table 9.9 Related and Supporting Industries

Related and Supporting Industries
A very strong agriculture business helps support the cattle industry—which accounted for approximately $8.33 billion dollars worth of exports in 2018.
Excellent steel makers and engine manufacturers support the production of one of America's most lucrative exports—commercial aircraft.
The pharmaceutical industry benefits from the research skills possessed by university-affiliated hospitals.
America's excellent performing arts schools such as the Juilliard School cultivate the talents of world-famous American performers.

Could Italian shoemakers create some of the world's best shoes if Italian leather makers were not among the world's best? Possibly, but it would be much more difficult. The concept of related and supporting industries refers to the extent to which firms' domestic suppliers and other complementary industries are developed and helpful (Table 9.9). Italian shoemakers such as Salvatore Ferragamo, Prada, Gucci, and Versace benefit from the availability of top-quality leather within their home country. If these shoemakers needed to rely on imported leather, they would lose flexibility and speed.

The auto industry is a setting where related and supporting industries are very important. Electronics are key components of modern vehicles. South Korean automakers Kia and Hyundai can leverage the excellent electronics provided by South Korean firms Samsung and LG. Similarly, Honda, Nissan, and Toyota are able to draw on the skills of Sony and other Japanese electronics firms. Unfortunately, for French automakers Renault and Peugeot, no French electronics firms are standouts in the international arena. This situation makes it difficult for Renault and Peugeot to integrate electronics into their vehicles as effectively as their South Korean and Japanese rivals.

Figure 9.13: Fine Italian shoes, such as those found at the famous Via Montenapoleone in Milan, are usually made of fine Italian leather.

In extreme cases, the poor condition of related and supporting industries can undermine an operation. Otabo LLC, a small custom shoe company, was forced to shut down its Florida factory as it struggled to find technicians that had the skills needed to fix its shoe making machines. Meanwhile, there are very few suppliers of shoelaces, soles, eyelets, and other components in the United States because about 99% of the shoes purchased in the United States are imported, mostly from China. The few available suppliers were unwilling to create the small batches of customized materials that Otabo wanted. In the end, the American factory simply could not get access to many of the supplies needed to create shoes (Aeppel, 2008). Production was shifted to China, where all the needed supplies can be found easily and cheaply.

Firm Strategy, Structure, and Rivalry

The concept of firm strategy, structure, and rivalry within the diamond model refers to how challenging it is to survive domestic competition. When domestic competition is fierce, the survivors are well prepared for the international arena. Below we offer examples of some of the most renowned exports that have resulted from the intense competition in domestic markets.

Table 9.10 Strategy, Structure, and Rivalry

Successful Export Examples
Cuban cigar brands such as Chiba are treasured by cigar aficionados around the globe. Despite US trade sanctions, cigars remain a leading export from Cuba.
Belgian firms produce over 200 million tons of chocolate each year. Brands that prosper despite this domestic competition stand out when they compete overseas.
Say “domo arigato” (Thank you very much) to the Japanese electronics industry, where competitors Seiko, Sony, Hitachi, and others push each other to bring smiles to the faces of consumers wanting a new watch, camera, video game system, or robot.
Over one million weavers work in Iran’s Persian rug industry. Part of the magic behind these world-famous carpets is that excellence is needed in order to fly above a crowded domestic market.
German breweries produce over five thousand brands of beer. With this high level of domestic rivalry, it is not surprising that German beers excel worldwide.
US movie studios have collectively dominated the global scene since the days of Charlie Chaplin and other silent-film stars.

The concept of firm strategy, structure, and rivalry refers to how challenging it is to survive domestic competition (Table 9.10). The Olympics offer a good analogy for illustrating the positive aspects of very challenging domestic situations. If the competition to make a national team in gymnastics is fierce, the gymnasts who make the team will have been pushed to stretch their abilities and performance. In contrast, gymnasts who faced few contenders in their quest to make a national team will not have been tested with the same level of intensity. When the two types meet at the Olympics, the gymnasts who overcame huge hurdles to make their national teams are likely to have an edge over athletes from countries with few skilled gymnasts.

Figure 9.14: Succeeding despite difficult domestic competition prepares firms to expand their kingdoms into international markets.

Companies that have survived intense rivalry within their home markets are likely to have developed strategies and structures that will facilitate their success when they compete in international markets. Hyundai and Kia had to keep pace with each other within the South Korean market before expanding overseas. The leading Japanese automakers, Honda, Nissan, and Toyota, have had to compete not only with one another but also with smaller yet still potent domestic firms such as Isuzu, Mazda, Mitsubishi, Subaru, and Suzuki. In both examples, the need to navigate potent domestic rivals has helped firms later become fearsome international players.

If, in contrast, domestic competition is fairly light, a company may enjoy admirable profits within its home market. However, the lack of being pushed by rivals will likely mean that the firm struggles to reach its potential in creativity and innovation. This undermines the firm’s ability to compete overseas and makes it vulnerable to foreign entry into its home market. Because neither Renault nor Peugeot has been a remarkable innovator historically, these French automakers have enjoyed fairly gentle domestic competition. Once the auto industry became a global competition, however, these firms found themselves trailing their Asian rivals.

Section Video

Porter's Diamond explained with an example [03:07]

The video for this lesson explains the Porter's Diamond framework by using an example.

You can view this video here: https://youtu.be/NM5Lwj-RZ34.

Key Takeaway

- The likelihood that a firm will succeed when it competes in international markets is shaped by four aspects of its domestic market: (1) demand conditions; (2) factor conditions; (3) related and supporting industries; and (4) strategy, structure, and rivalry among its domestic competitors.

Exercises

1. Which of the four elements of the diamond model do you believe has the strongest influence on a firm's fate when it competes in international markets?
2. Automakers in China and India have yet to compete on the world stage. Based on the diamond model, would these firms be likely to succeed or fail within the global auto industry?

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Figure 9.12: Francis Eatherington. “Seneca Lumber spraying herbicides.” CC BY-NC 2.0. Retrieved from https://www.flickr.com/photos/umpquawild/13517864965/.

Figure 9.13: Warburg. “Shop.” CC BY-SA 3.0. Retrieved from https://en.wikipedia.org/wiki/File:Milan_Montenapoleone_16.JPG.

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Video Credits

Simply-ptrn. (2015, November 29). *Ep 1: Porter’s Diamond explained with an example* [Video]. YouTube. https://youtu.be/NM5Lwj-RZ34.

9.6 Options for Competing in International Markets

French philosopher Michel de Montaigne once quipped that marriage is "a market which has nothing free but the entrance." When trying to match their goods and services with the promise of love from a new market, executives have multiple entry options—but they should carefully consider each, lest the romance be short-lived.

Table 9.11 Market Entry Options

Exporting	Exporting involves creating goods at home and then shipping them to another country. Civilian aircraft are a top-ten US export to countries such as Japan, China, Germany, Italy, and France that want to make their skies friendlier for travel.
Licensing	Licensing involves granting a foreign company the right to create a company's product in exchange for a fee. This option is frequently used in manufacturing industries, such as when Coca-Cola licenses their secret formulas to local bottlers (without revealing the formulas, of course).
Franchising	Franchising involves "renting" a firm's brand name and business processes to local entrepreneurs. Curves International has used franchising to bulk up its fitness empire to include over thirty countries.
Joint Venture	In a joint venture, two or more organizations each contribute to the creation of a new entity. In a strategic alliance, firms work together cooperatively without forming a new organization. Global Nuclear Fuel Co.—a collaboration among General Electric, Toshiba Corporation, and Hitachi Limited—is an example of a joint venture.
Acquisition/Wholly owned Subsidiary	Acquisition/wholly owned subsidiary is when a firm acquires a business operation in a foreign country. The firm fully owns the acquired company. Intel established IPLS—a wholly owned subsidiary in Ireland—to facilitate and manage its research throughout the "Emerald Isle." Smithfield Foods, the world's largest producer of pork products and located in Virginia, was acquired by a Chinese company for nearly $5 million.
Greenfield/Wholly owned subsidiary	Greenfield/wholly owned subsidiary is when a company enters a foreign country and buys property and constructs their business. This could be a manufacturer building a plant, or a retailer building a store, as opposed to acquiring an existing one. BMW used this approach to build its car manufacturing plant in South Carolina.

When the executives in charge of a firm decide to enter a new country, they must decide how to enter the country. There are six basic options available: (1) exporting, (2) licensing, (3) franchising, (4) creating a joint venture or strategic alliance (5) acquisition/creating a wholly owned subsidiary, and (6) greenfield/wholly owned subsidiary (Table 9.11). These options vary in terms of how much control a firm has over its operation, how much risk is involved, and what share of the operation's profits the firm gets to keep.

It is important to note that these options are not exclusively for implementing international strategy. As discussed in Chapter 8, all but exporting are also methods to accomplish corporate strategies in their domestic markets to diversify their portfolio.

As shown in Figure 9.3, there are trade-offs in the selection of the method of entry to another country. These variables are:

- The amount of risk
- The degree of control and ownership
- The potential for profit

Exporting provides the least amount of risk, but also the least amount of control and profit potential. Moving from exporting at one end of the continuum to greenfield on the other end, the amount of risk increases, as does the degree of control/ownership and the potential to make more profit. The most risky method to enter into another country is greenfield, when the investment is high in acquiring land and building facilities, without the advantage of taking over an existing company. However, the venture is totally under the control of the entering company and the profit potential is the highest, although riskiest, as noted.

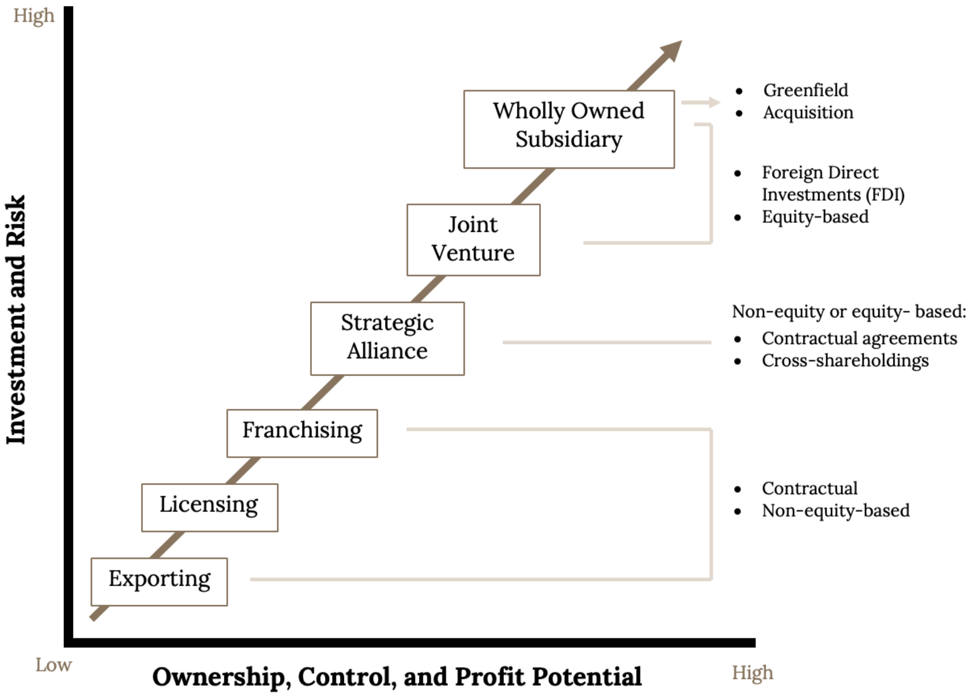

Figure 9.15: Entering International Markets

Exporting

Exporting involves creating goods within a firm's home country and then shipping them to another country. Once the goods reach foreign shores, the exporter's role is over. A local firm then sells the goods to local customers. Many firms that expand overseas start out as exporters because exporting offers a low-cost method to find out whether a firm's products are appealing to customers in other lands. Some Asian automakers, for example, first entered the US market through exporting. Small firms may rely on exporting because it is a low-cost and lower risk option.

Once a firm's products are found to be viable in a particular country, exporting often becomes undesirable. A firm that exports its goods loses control of them once they are turned over to a local firm for sale locally. This local distributor may treat customers poorly and thereby damage the firm's brand. Also, an exporter only makes money when it sells its goods at wholesale prices to a local firm, not when end users buy the goods. Executives may want their firm to enjoy the profits that are made when products are sold to individual customers rather than a local distributor.

Figure 9.16: Exporting often relies on huge cargo ships, such as this one docked in Cyprus.

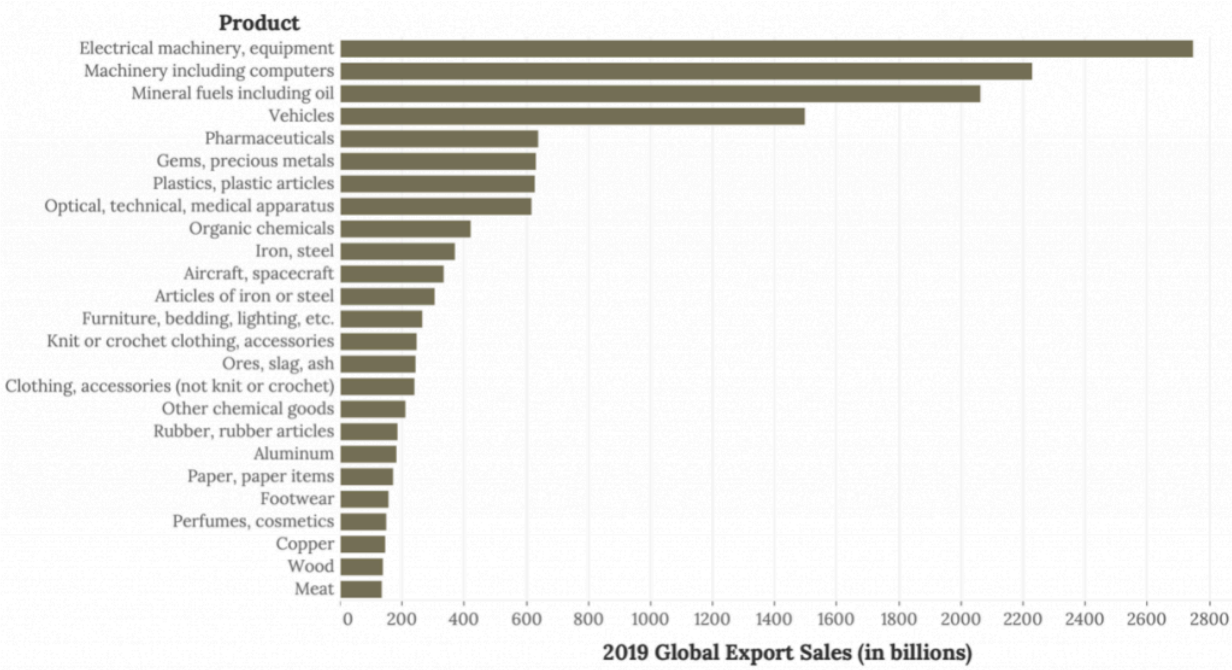

Figure 9.17: What gets exported from one country to another?

Licensing

While franchising is an option within service industries, licensing is most frequently used in manufacturing industries. Licensing involves granting a foreign company the right to create a company's product within a foreign country in exchange for a fee. These relationships often center on patented technology. A firm that grants a license avoids absorbing a lot of costs, but its profits are limited to the fees that it collects from the local firm. The firm also loses some control over how its technology is used.

A historical example involving licensing illustrates how rapidly events can change within the international arena. By the time Japan surrendered to the United States and its Allies in 1945, World War II had crippled the country's industrial infrastructure. In response to this problem, Japanese firms imported a great deal of technology, especially from American firms. When the Korean War broke out in the early 1950s, the American military relied on Jeeps made in Japan using licensed technology. In just a few years, a mortal enemy had become a valuable ally.

Strategy at the Movies

Gung Ho

Figure 9.18: Assembly line at car factory in South Korea.

Can American workers survive under Japanese management? Although this sounds like the premise for a bad reality TV show, the question was a legitimate consideration for General Motors (GM) and Toyota in the early 1980s. GM was struggling at the time to compete with the inexpensive, reliable, and fuel-efficient cars produced by Japanese firms. Meanwhile, Toyota was worried that the US government would limit the number of foreign cars that could be imported. To address these issues, these companies worked together to reopen a defunct GM plant in Fremont, California in 1984 that would manufacture both companies' automobiles in one facility. The plant had been the worst performer in the GM system; however, under Toyota's management, the New United Motor Manufacturing Incorporated (NUMMI) plant became the best factory associated with GM—using the same workers as before! Despite NUMMI's eventual success, the joint production plant experienced significant growing pains stemming from the cultural differences between Japanese managers and American workers.

The NUMMI story inspired the 1986 movie *Gung Ho* in which a closed automobile manufacturing plant in Hadleyville, Pennsylvania, was reopened by Japanese car company Assan Motors. While Assan Motors and the workers of Hadleyville were both excited about the venture, neither was prepared for the differences between the two cultures. For example, Japanese workers feel personally ashamed when they make a mistake. When manager Oishi Kazihiro failed to meet production targets, he was punished with “ribbons of shame” and forced to apologize to his employees for letting them down. In contrast, American workers were presented in the film as likely to reject management authority, prone to fighting at work, and not opposed to taking shortcuts.

When Assan Motors’ executives attempted to institute morning calisthenics and insisted that employees work late without overtime pay, the American workers challenged these policies and eventually walked off the production line. Assan Motors’ near failure was the result of differences in cultural norms and values. *Gung Ho* illustrates the value of understanding and bridging cultural differences to facilitate successful cross-cultural collaboration, value that was realized in real life by NUMMI.

Franchising

Franchising is a popular way for firms to grow internationally. Below are examples of US-based franchises that are successful worldwide.

Table 9.12 Franchising: A Leading American Export

Successful US-based Franchises
In many Asian countries, McDonald’s franchises offer side dishes such as rice alongside its signature French fries.
If you grow tired of strudel while in Germany, remember that Dunkin’ Donuts has over 3,200 stores in 36 countries outside of the United States.
Legend says that the first sandwich was created when John Montagu, the fourth Earl of Sandwich, ordered meat tucked between bread so he could play cards and eat at the same time. The sandwich remains popular in Europe, where Subway boasts over one thousand franchised restaurants.
All KFCs in Japan prominently feature a statue of KFC’s founder Colonel Sanders.
If a franchised store in Norway was open during the age of the Vikings, its slogan may have been “Thank Asgard for 7-11.”

Franchising has been used by many firms that compete in service industries to develop a worldwide presence (Table 9.12). Subway, The UPS Store, and Hilton Hotels are just a few of the firms that have done so. Franchising involves an organization (called a franchiser) granting the right to use its brand name, products, and processes to other organizations (known as franchisees) in exchange for an up-front payment (a franchise fee) and a percentage of franchisees’ revenues (a royalty fee).

Figure 9.19: Firms should own a thoroughly proven business model before franchising in other countries.

Franchising is an attractive way to enter foreign markets because it requires little financial investment by the franchiser. Indeed, local franchisees must pay the vast majority of the expenses associated with getting their businesses up and running. On the downside, the decision to franchise means that a firm will get to enjoy only a small portion of the profits made under its brand name. Also, local franchisees may behave in ways that the franchiser does not approve. For example, KFC was angered by some of its franchisees in Asia when they started selling fish dishes without KFC's approval. It is often difficult to fix such problems because laws in many countries are stacked in favor of local businesses. Last, franchises are only successful if franchisees are provided with a simple and effective business model. Executives thus need to avoid expanding internationally through franchising until their formula has been perfected.

Joint Ventures and Strategic Alliances

Within each market entry option described earlier, a firm either maintains strong control of operations (wholly owned subsidiary) or it turns most control over to a local firm (exporting, franchising, and licensing). In some cases, however, executives find it beneficial to work closely with one or more local partners in a joint venture or a strategic alliance. In a joint venture, two or more organizations each contribute to the creation of a new entity. In a strategic alliance, firms work together cooperatively, but no new organization is formed. In both cases, the firm and its local partner or partners share decision-making authority, control of the operation, and any profits that the relationship creates.

Joint ventures and strategic alliances are especially attractive when a firm believes that working closely with locals will provide important knowledge about local conditions, facilitate acceptance of their involvement by government officials, or both. In the late 1980s, China was a difficult market for American businesses to enter. Executives at KFC saw China as an attractive country because chicken is a key element of Chinese diets. After considering the various options for entering China with its first restaurant, KFC decided to create a joint venture with three local organizations. KFC owned 51% of the venture; having more than half of the operation was advantageous in case disagreements arose. A Chinese bank owned 25%, the local tourist bureau owned 14%, and the final 10% was owned by a local chicken producer that would supply the restaurant with its signature food item.

Having these three local partners helped KFC navigate the cumbersome regulatory process that was in place and allowed the American firm to withstand the scrutiny of wary Chinese officials. Despite these advantages, it still took more than a year for the store to be built and approved. Once open in 1987, however, KFC was an instant success in China. As China's economy gradually became more and more open, KFC was a major beneficiary. By the end of 1997, KFC operated 191 restaurants in 50 Chinese cities. By the start of 2019, there were approximately 5,000 KFCs spread across 1,100 Chinese cities. Roughly 90% of these restaurants are wholly owned subsidiaries of KFC—a stark indication of how much doing business in China has changed over the past twenty-five years.

Figure 9.20: As of early 2011, KFC was opening a new store in China every eighteen hours on average.

Creating a Wholly Owned Subsidiary: Acquisition and Greenfield

In international strategy, a wholly owned subsidiary is a business operation in a foreign country that a firm fully owns. A firm can develop a wholly owned subsidiary through a greenfield venture, meaning that the firm creates the entire operation itself. This usually means building and operating the facility. Another possibility is purchasing an existing operation from a local company or another foreign operator.

Regardless of whether a firm builds a wholly owned subsidiary "from scratch" or acquires an existing company, having a wholly owned subsidiary can be attractive because the firm maintains complete control over the operation, and gets to keep all of the profits that the operation makes. A wholly owned subsidiary can be quite risky, however, because the firm must pay all of the expenses required to set it up and operate it. Kia, for example, spent $1 billion to build its US factory. Many firms are reluctant to spend such sums in more volatile countries because they fear that they may never recoup their investments.

Section Videos

Global Market Entry Strategy [02:00]

The video for this lesson provides a short explanation of mode of entry to other countries.

You can view this video here: https://youtu.be/a5UaXsYV1aw.

A *level Business Revision-Entering International Markets* [08:25]

The second video for this lesson is longer, but a more thorough explanation of mode of entry to other countries.

You can view this video here: https://youtu.be/SGoGJEe-ERk.

Key Takeaway

- When entering a new country, executives can choose exporting, licensing, franchising, creating a joint venture or strategic alliance, and creating a wholly owned subsidiary through greenfield or acquisition. The key issues of how much control a firm has over its operation, how much risk is involved, and what share of the operation's profits the firm gets to keep all vary across these options. Along the continuum from exporting to wholly owned subsidiary, risk, control, and profit potential are least with exporting and highest with the wholly owned subsidiary.

Exercises

1. Do you believe that KFC would have been so successful in China today if executives had tried to make their first store a wholly owned subsidiary? Why or why not?
2. The typical joint venture only lasts a few years. Why might joint ventures dissolve so quickly?

Image Credits

Figure 9.15: Kindred Grey (2020). "Entering International Markets." CC BY-SA 4.0. Retrieved from https://commons.wikimedia.org/wiki/File:Entering_International_Markets.png.

Figure 9.16: Mar-Law. Cargo Ship in Channel. CC BY-NC 2.0. Retrieved from https://www.flickr.com/photos/seenlikethis/3032668425/ Edited photo to add brightness.

Figure 9.17: Kindred Grey (2020). "2019 World Exports by Product." CC BY-SA 4.0. Retrieved from https://commons.wikimedia.org/wiki/File:2019_World_Exports_by_Product.png. Data retrieved from https://en.wikipedia.org/wiki/International_trade.

Figure 9.18: Anonyme. "Assembly line at Hyundai Motor Company's car factory in Ulsan, South Korea." CC BY 2.5. Retrieved from https://commons.wikimedia.org/wiki/File:Hyundai_car_assembly_line.jpg.

Figure 9.20: Juxun, Chen. "KFC Restaraunt in China." CC BY-SA 3.0. Retrieved from https://commons.wikimedia.org/wiki/File:Kfc_of_china.jpg.

Video Credits

Lyana Lan. (2014, November 21). *Global market entry strategy* [Video]. YouTube. https://youtu.be/a5UaXsYV1aw.

TakingtheBiz. (2020, March 2). *A level business revision-entering international markets* [Video]. YouTube. https://youtu.be/SGoGJEe-ERk.

9.7 Conclusion

This chapter explains competition in international markets. Executives must consider the benefits and risks of competing internationally when making decisions about whether to expand overseas. Using the CAGE framework helps firms decide the cultural, administrative, geographic, and economic distance between the home and target country. Executives also need to determine the likelihood that their firms will succeed when they compete in international markets by examining demand conditions, factor conditions, related and supporting industries, strategy, structure, and rivalry among its domestic competitors. When a firm does venture overseas, a decision must be made about whether its international strategy will be international, multi-domestic, global, or transnational. Finally, when leading a firm to enter a new market, executives can choose to manage the operation via exporting, licensing, franchising, creating a joint venture or strategic alliance, and creating a wholly owned subsidiary through greenfield or acquisition.

Exercises

1. Divide your class into four or eight groups, depending on the size of the class. Each group should select a different industry. Find examples of each international strategy for your industry. Discuss which strategy seems to be the most successful in your selected industry.
2. This chapter discussed Kia and other automakers. If you were assigned to turn around a struggling automaker such as General Motors or Chrysler, what actions would you take to revive the company's prospects within the global auto industry?