The Strategy of International Business[1]

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1. The Strategy of International Business
    - Strategy of the Firm
    - Global Expansion, Profitability, and Profit Growth
    - Conflicting Pressures
    - Choosing a Strategy

Strategic Goals

Definition (Strategy)

A firm's *strategy* can be defined as the actions that managers take to attain the goals of the firm.

Definition (Profitability)

The rate of return that the firm makes on its invested capital (ROIC), calculated by dividing the net profits of the firm by total invested capital.

Definition (Profit Growth)

The percentage increase in net profits over time.

Determinants of Enterprise Value

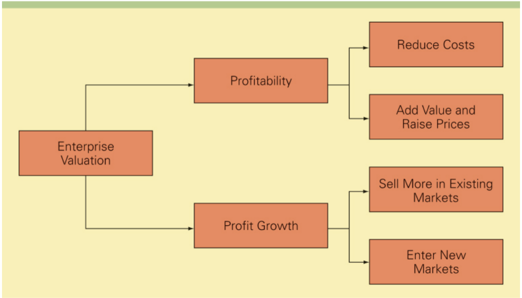

Figure: Hill Figure 12.1: Determinants of Enterprise Values

Measures of Profitability

Definition (Gross Margin)

A company's total sales revenue minus its cost of goods sold (COGS), divided by the total sales revenue, expressed as a percentage. The gross margin represents the percent of total sales revenue that the company retains after incurring the direct costs associated with producing the goods and services sold by a company [4].

$$\text{Gross Margin} = \frac{\text{Gross Revenues} - \text{COGS}}{\text{Gross Revenue}}$$

Measures of Profitability (Continued)

Definition (Operating Margin)

Operating margin is the ratio of operating income to net sales:

$$\text{Operating Margin} = \frac{\text{Operating Income}}{\text{Net Sales}}$$

Operating margin is a measurement of what proportion of a company's revenue is left over after paying for variable costs of production such as wages, raw materials, etc. and gives analysts an idea of how much a company makes (before interest and taxes) on each dollar of sales by providing a measure of a company's pricing strategy and operating efficiency [8].

Measures of Profitability (Continued)

Definition (Operating Income)

Operating income takes the gross income (revenue minus COGS) and subtracts other operating expenses incurred from operating activities, which include things such as office supplies and heat and power, and then removes depreciation. A synonym for earnings before interest and taxes (EBIT). [7].

Measures of Profitability (Continued)

Definition (Net Margin)

The ratio of net profits to revenues for a company or business segment – typically expressed as a percentage – that shows how much of each dollar earned by the company is translated into profits.

$$\text{Net Margin} = \frac{\text{Net Profit}}{\text{Revenues}}$$

Net profits are composed of revenues less cost of goods sold (COGS) less operating expenses less interest and taxes [6].

Measures of Profitability (Continued)

Definition (Contribution Margin)

A cost accounting concept that allows a company to determine the profitability of individual products. Contribution margin is calculated as:

$$\text{Contribution Margin} = \frac{\text{Product Revenue} - \text{Product Variable Costs}}{\text{Product Revenue}}$$

The phrase "contribution margin" can also refer to a per unit measure of a product's gross operating margin, calculated simply as the product's price minus its total variable costs [2].

Enterprise Valuation

There are a variety of generally accepted means by which enterprise value is determined.

Premises of value:

- Going concern value
- Liquidation value

Approaches to enterprise valuation fall into three broad categories:

1. Market based approach
2. Income based approach
3. Asset based approach

Enterprise Valuation (Continued)

Definition (Going Concern Value)

The value of an enterprise as an ongoing entity [3].

Definition (Liquidation Value)

The total worth of a company's physical assets when it goes out of business or if it were to go out of business. Liquidation value is determined by assets such as the real estate, fixtures, equipment and inventory a company owns. Intangible assets are not included in a company's liquidation value. Intangible assets include a business's intellectual property, goodwill and brand recognition [5].

Strategic Positioning

Harvard professor Michael Porter has argued that the primary strategies for creating value and attaining a competitive advantage in an industry include *low-cost* and *differentiation* strategies [1, p. 422].

Profits can be increased by:

1. Adding value to a product so that customers are willing to pay more for it
2. Lowering costs

Strategic Positioning (Continued)

Economists refer to the sum of *consumer surplus* and *producer surplus* (profits) as the *social surplus*.

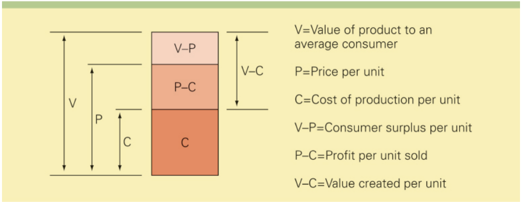

Figure: Hill Figure 12.2: Value Creation

Strategic Positioning (Continued)

Dr. Porter has argued that firms much chose either differentiation or low cost strategies, and then mobilize operations to support the choice.

To maximize long run return on invested capital, firms must:

1. Pick a viable position on the efficiency frontier, and
2. Configure operations to support that position
3. Have the right structure and organization in place to execute on the firm's strategy

Strategic Positioning (Continued)

Definition (Operations Management)

The administration of business practices to create the highest level of efficiency possible within an organization. Operations management is concerned with converting materials and labor into goods and services as efficiently as possible to maximize the profit of an organization [9].

Strategic Positioning (Continued)

To achieve and maintain a competitive advantage and garner superior profitability, firms should strive to maintain consistent strategy, operations, and organization of the firm [1, p. 423].

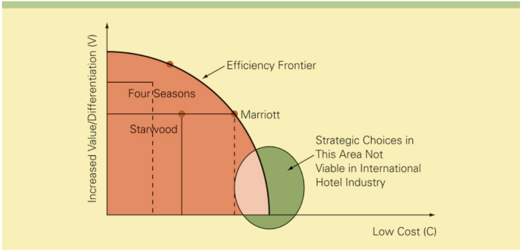

Figure: Hill Figure 12.3: Strategic Choice in the International Hotel Industry

Operations and the Value Chain

Definition (Value Chain)

The set of distinct value creation activities in which a firm engages, including production, marketing and sales, materials management, R&D, human resources, information systems, and the firm infrastructure.

Primary activities include:

- Production
- Marketing and sales
- Customer Service
- Research and Development (R&D)

Support activities include:

- Human Resources
- Logistics
- Information Systems

Expanding Internationally by Leveraging Products and Competencies

- Firms can increase growth by selling goods or services developed at home internationally
- Firms' international success depends both on the goods or services they sell and on their core competencies
- Core competencies enable the firm to reduce the costs of value creation and/or to create perceived value in such a way that premium pricing is possible

Definition (Core Competencies)

Skills within the firm that competitors cannot easily match or imitate

Global Expansion, Profitability, and Profit Growth

Firms that expand into international markets can

- Expand the market for domestic product offerings
- Realize location economies
- Realize cost economies from learning effects and economies of scale
- Leverage valuable skills developed in foreign operations

Location Economies and Economies of Scale

Definition (Economies of Scale)

Reductions in unit costs achieved by producing a large volume of a product.

Definition (Location Economies)

The economies that arise from performing a value creation activity in the optimal location for that activity accounting for transportation costs and other trade barriers.

Location Economies and Economies of Scale (Continued)

Benefits of localization economies:

- Firms that take advantage of location economies create a global web of value creation activities
- Different parts of the value chain are dispersed to those locations around the globe where perceived value is maximized or where costs are minimized
- Thus, by achieving localization economies, firms can lower the costs of value creation and achieve a low cost position as well as differentiate product offerings

Note that transportation costs, trade barriers, and political risks complicate this picture.

Experience Effects

Definition (Experience Curve)

Systematic reductions in production costs that have been observed to occur over the life of a product.

Definition (Learning Effects)

Cost savings that come from "learning by doing."

The Experience Curve

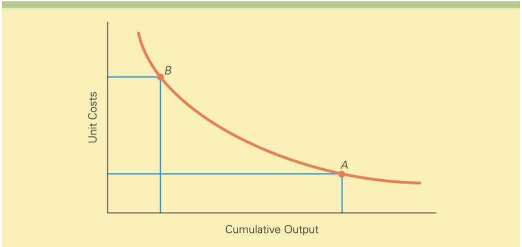

Figure: Hill Figure 12.5: The Experience Curve

How to Realize Efficiencies

To realize efficiencies,

- Recognize that valuable skills that could be applied elsewhere in the firm can arise anywhere within the firm's global network (not just at the corporate center)
- Establish an incentive system that encourages local employees to acquire new skills
- Have a process for identifying when valuable new skills have been created in a subsidiary

Conflicting Pressures

Multinational firms face conflicting incentives

- Cost reduction
- Local responsiveness

Different firms adopt different strategies depending on the nature of the pressures

- Global standardization strategy
- Localization strategy
- Transnational strategy
- International strategy

Pressures for Cost Reductions

Pressures for cost reductions are greatest ...

- ... in industries producing commodity type products that fill universal needs where price is the main competitive weapon
- ... when major competitors are based in low cost locations
- ... where there is persistent excess capacity
- ... where consumers are powerful and face low switching costs

Definition (Universal Needs)

Needs that exist when the tastes and preferences of consumers in different nations are similar if not identical.

Pressures for Local Responsiveness

Pressures for local responsiveness arise from ...

- ...differences in consumer tastes and preferences
  - Strong pressures for local responsiveness emerge when consumer tastes and preferences differ significantly between countries
- ...differences in traditional practices and infrastructure
  - Pressures for local responsiveness emerge when there are differences in infrastructure and/or traditional practices between countries
- ...differences in distribution channels
  - A firm's marketing strategies needs to be responsive to differences in distribution channels between countries
- ...host government demands
  - Economic and political demands imposed by host country governments may necessitate a degree of local responsiveness

Strategic Choices

Definition (Global Standardization Strategy)

A strategy that focuses on increasing profitability and profit growth by reaping the cost reductions that come from economies of scale, learning effects, and locating economies. Their strategic goal is to pursue a low-cost strategy on a global scale.

Definition (Localization Strategy)

A strategy that focuses on increasing profitability by customizing the firm's goods or services so they provide a good match to tastes and preferences in different national markets.

Strategic Choices (Continued)

Definition (Transnational Strategy)

A strategy that tries to simultaneously achieve low costs through location economies, economies of scale, and learning effects, differentiate product offerings across geographic markets to account for local differences, and foster a multidirectional flow of skills between different subsidiaries in the firm's global network of operations.

Definition (International Strategy)

A strategy in which products are first produced for the domestic market, then sold internationally with minimal customization.

Choosing a Strategy

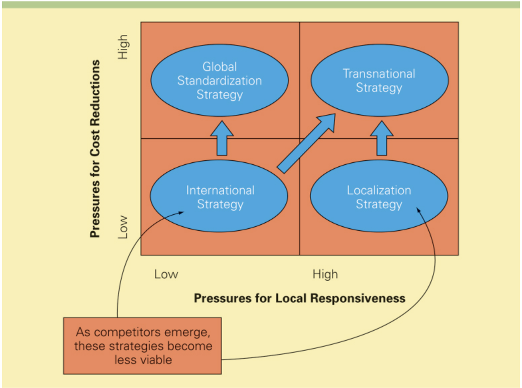

Figure: Hill Figure 12.8: Choosing a Strategy

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