FACULTY
OF INTERNATIONAL
RELATIONS

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Global Business and International Trade

Strategy of international business – part 1

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Outline of the lecture

- Strategy and the firm
- Value creation
- Strategic positioning
- Internal operations
- Global expansion

Introduction

- Our class has so far covered the macro economic environment of a company
- Now we shift to the company itself and to its strategy of expanding operations to foreign markets pursuing a goal of increasing profitability
- That is international business strategy

Basic terms and principles

- Firm's strategy
  - The actions that managers take to attain the goals of the firm
  - For most companies, the basic aim is to maximize the value of the firm for its owners
  - Determinants of a firm's value:
    - Profitability
    - Profit growth
  - ➢ Managers should pursue strategies that increase profitability or the rate of profit growth over time

Basic terms and principles

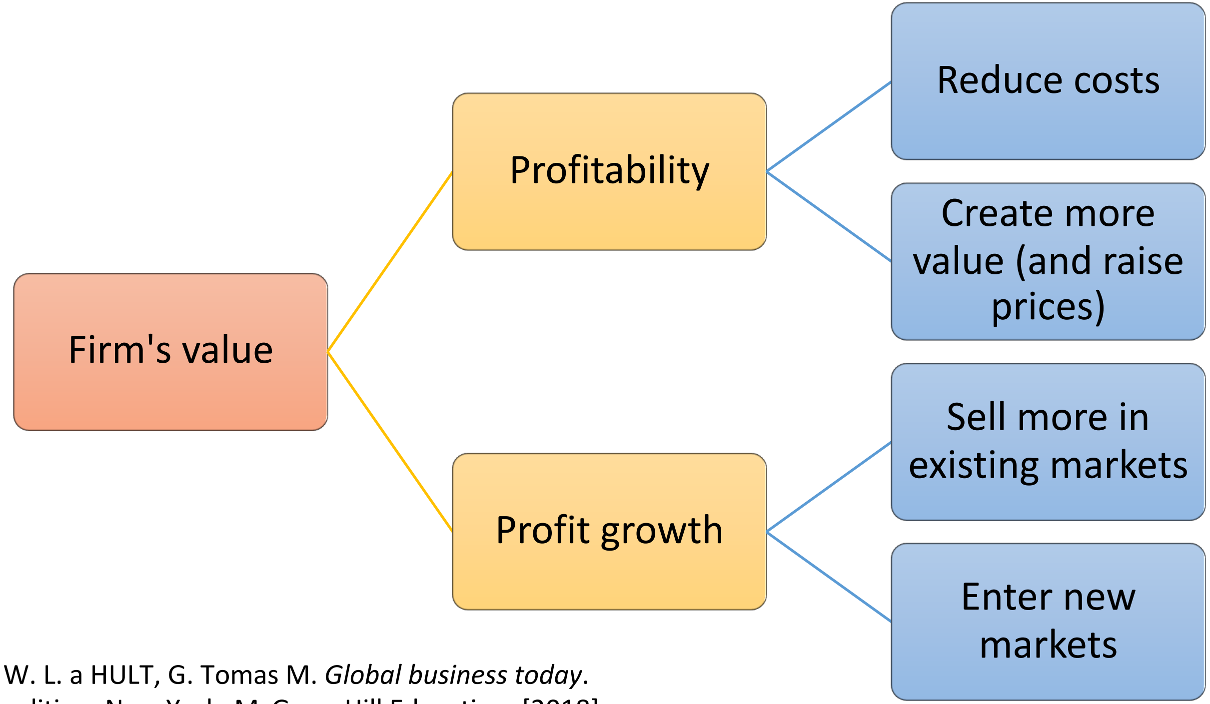
- Higher profitability and a higher rate of profit growth will increase firms' value and thus the returns to its owners

Basic terms and principles

- Profitability
  - Percentage return that a company earns on invested capital (ROIC)
  - Net operating profit after tax divided by invested capital
  - Value creator x value destroyer

- Profit growth
  - Percentage increase in net profits over time

Basic terms and principles



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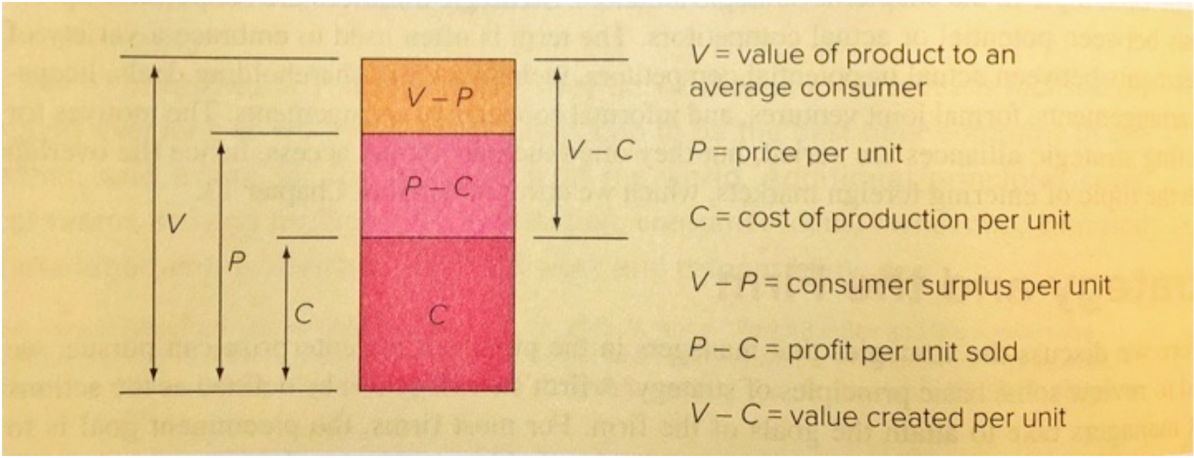
Value creation (value to consumers)

- The amount of value a firm creates is measured by the difference between its costs of production and the value that consumers perceive in its products
- The more value consumers place, the higher price the firm can charge

Value creation

- But the value that consumers perceive is typically <u>not charged</u> (firms charge less)
- In competitive markets <u>competition</u> must be considered and thus what is charged is less than what could be charged if that was monopoly
- Also, firm can’t charge individual customers individual prices
- The difference between perceived value and final price is called consumer surplus (“value for money” concept)

Value creation



- In general, the higher the firms (V–C), the greater its profitability will be

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Value creation

- It is measured by the difference (V-C)
- Interpretation: company creates value by converting inputs that cost C into a product on which consumers place a value of V

Value creation

- More value can be created by:
  - Lowering production costs, or
  - Making products (or other related features) more attractive, or
  - Combination of the previous

Value creation

- Strategies:
  - Low-cost strategy (focuses primarily on lowering production costs)
  - Differentiation strategy (focuses primarily on increasing attractiveness of products – increase in V)
    - Company can ask for a higher price

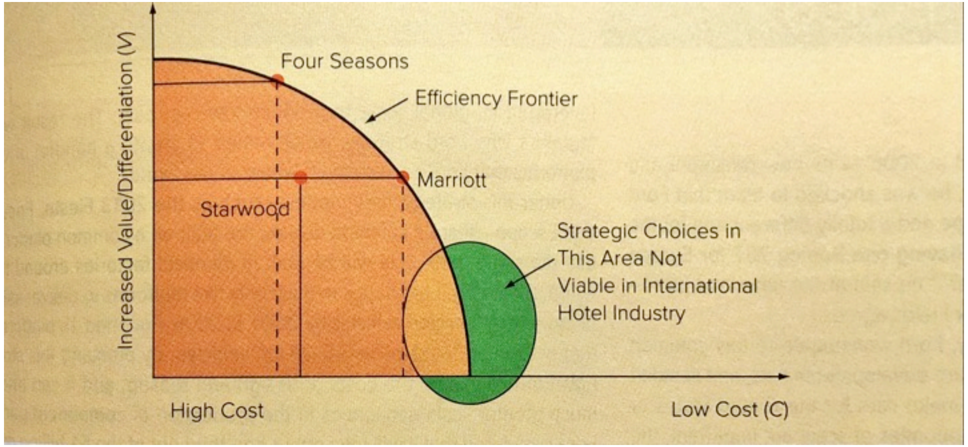
Value creation

- According to Michael Porter, superior profitability goes to firms that can create superior value
- Superior value doesn’t necessarily mean lowest cost structure or the most valuable product
  - Important is the size of the gap (V-C)

Strategic positioning

- Firms must be explicit about their choice of strategic emphasis with regard to value creation (differentiation) and low costs
- Internal operations of the company have to support that strategic emphasis
- Efficiency frontier is illustrated in the next slide

Strategic positioning



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Strategic positioning

- To maximize profitability, a firm must
  1. Pick a viable position on the EF (enough demand)
  2. Configure its internal operations so that they support that position (coming soon)
  3. Make sure that it has the right organizational structure to execute its strategy

Operations – firm as a value chain

- Operations
  - Various value creation activities a firm undertakes
  - Production, marketing, sales, purchase, R&D, HR, IT, …
  - Can be classified:
    - Primary activities
    - Support activities

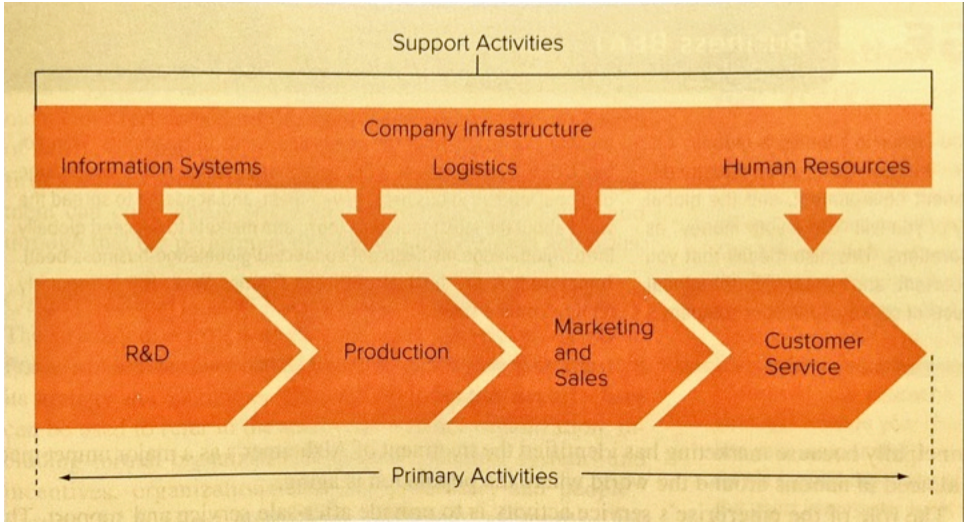
Operations – firm as a value chain

- Primary activities
  - Design, creation and delivery of the product
  - Marketing, sales or after-sale service
  - All activities have impact on either V or C (or both)

Operations – firm as a value chain

- Support activities
  - Provide inputs that allow primary activities to occur
  - They tend to be as important as the primary activities

Operations – firm as a value chain



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Global expansion

- Global expansion allows companies to increase firm's value by:
  1. Offering domestic products in international markets
  2. Realizing location economies
  3. Realizing greater cost economies
  4. Leveraging valuable skills developed in foreign operations

Expanding the market

- A company can increase its growth rate by taking goods or services developed at home and selling them internationally
- Typical process by MNCs

Expanding the market

- Company's success is based not just upon the good or service, but also upon the core competencies
  - Firm skills that competitors can't easily match or imitate
  - Can be found in any of the firm's value creation activities
    - Production, marketing, HR, R&D or logistics

Expanding the market

- Core competencies are the source of a firm’s competitive advantage
- Global expansion thus means also transfer of them to foreign markets

Location economies

- Countries are different in various factors
- The firm will benefit by basing each value creation activity at that location, where conditions (PEST) are most conductive to the performance of that activity

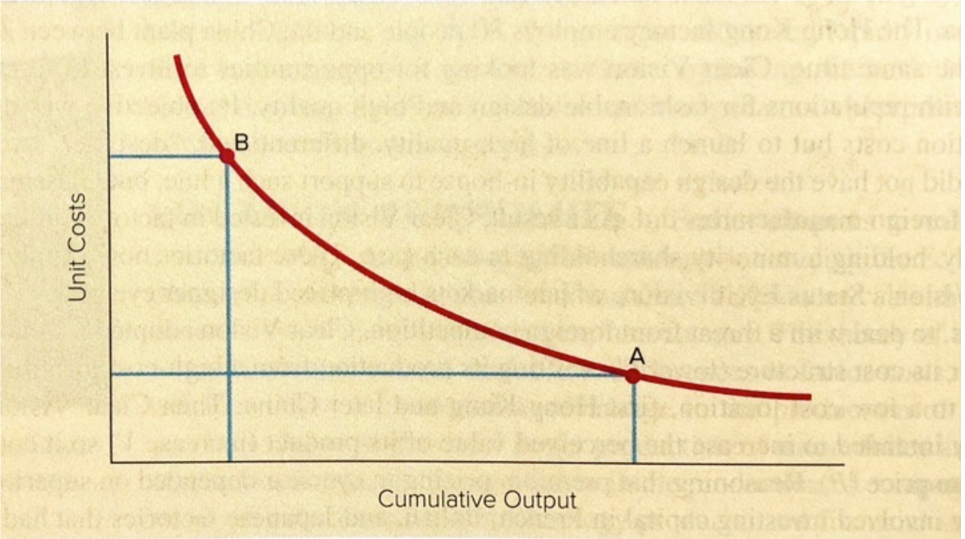
Location economies

- Pursuing that strategy is called location economies, which are economies arising from performing an activity in the optimal location
- This can lead to:
  1. Lower costs of value creation, or/and
  2. Differentiation of product offerings from competitors and increase in V

Cost economies

- Experience curve
  - Systematic reductions in production costs that occur over the life of a product
  - Studies have shown that product's production costs decline about each time cumulative output doubles

Cost economies



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Cost economies

- Experience effects can be explained by:
  - Learning effect
    - Cost saving by learning by doing
    - The more complex production, the higher this effect
    - Disappears with time anyway
  - Economies of scale
    - Reduction in unit cost achieved by producing a large volume
    - Spreading fixed costs over large volume
    - Sometimes only possible when serving global markets
    - Bargaining power

Leveraging valuable skills

- Creation of skills is not monopoly of the corporate center
- Leveraging skills created within subsidiaries and applying them to other operations within the firm’s global network may create value