14.4: Global Buisness Strategies

What you'll learn to do: evaluate common strategies used to reach global markets

Globalization introduces a number of challenges that are unique to operating simultaneously in different countries and global markets. What is the best way to enter or take advantage of a global market? When should you adjust a product's features to customize it to consumer needs in a different global market? How do you manage the costs and complexities of producing and/or promoting products in different locations, with different languages, cultural sensitivities, and consumer expectations?

While this next section doesn't attempt to answer all of these questions, it explains common strategies and approaches used by multinational corporations to take advantage of global business opportunities.

Learning Objectives

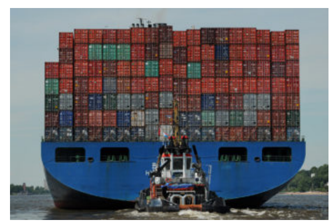
- Explain how firms use licensing and franchising to reach global markets
- Explain how firms use joint ventures and foreign strategic alliances to reach global markets

Global Business Strategies

In today's economy, once a nation or business has developed an advantage—either comparative or absolute—it's likely to look beyond its own borders or storefront to seek greater economic opportunity. But how do you enter a global market? It's certainly not as simple as loading up your products in a van, driving to the next town, and knocking on doors. Below are some of the common strategies companies and countries use to get their goods and services into global markets.

Exporting/Importing

Figure 14.4.1: Shipping Containers



Exporting is the easiest and most straightforward way to engage with the global market. **Exporting** is taking goods that were produced within a company's home country and shipping them to another country. The party sending the good is called an *exporter*. It is impossible to discuss exporting without mentioning its complement, importing. **Importing** is the process by which a good is brought into a jurisdiction, especially across a national border, from an external source. The party bringing in the good is called an *importer*. Simply put, one country's exports become another country's imports. Examples of U.S. imports are everywhere: Take a look at the labels in your clothes or the contents of your backpack. From our vantage point, U.S. exports may be a little harder to see, but they exist all the same and are plenty visible in other countries. According to *World's Top Exports*, the following export product groups represent the highest dollar value in American global shipments during 2015. In parentheses is the percentage share each export category represents in terms of overall U.S. exports:

1. Machines, engines, pumps: US$205.8 billion (13.7% of total exports)
2. Electronic equipment: $169.8 billion (11.3%)
3. Aircraft, spacecraft: $131.1 billion (8.7%)
4. Vehicles: $127.1 billion (8.4%)
5. Oil: $106.1 billion (7.1%)
6. Medical, technical equipment: $83.4 billion (5.5%)
7. Plastics: $60.3 billion (4%)
8. Gems, precious metals, coins: $58.7 billion (3.9%)
9. Pharmaceuticals: $47.3 billion (3.1%)
10. Organic chemicals: $38.8 billion (2.6%)[1]

Advantages and Disadvantages

Since exporting doesn't require a company to manufacture its products in the target country, the company doesn't have to invest in factories, equipment, or other production facilities located halfway around the globe. Most of the costs involved in exporting are associated with finding a buyer or distributor in the destination market. For these reasons, exporting is considered to be the quickest and least expensive means to enter the global market. However, there are disadvantages, too.

Once products arrive in the destination market, the business loses control of them, which can result in products being misrepresented, copied by other manufacturers, or even sold on a black market. In addition, because the business isn't active in the new market, it can't gain insight into or experience with local consumer preferences and demand. This lack of information can create uncertainty and potentially cost the company opportunities down the road. As you will learn later in this module, businesses operating in other countries may find themselves subject to taxes, regulations, and/or restrictions that can substantially affect the profitability of the entire export venture.

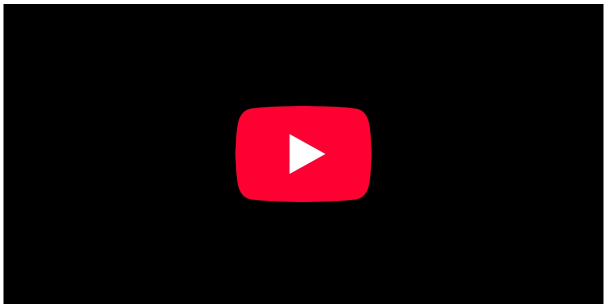
Outsourcing/Offshoring

Figure 14.4.2 Garment factory, Jiaxing, China

Outsourcing and offshoring are two additional strategies that a business can use in order to take advantage of the global market. **Outsourcing** *contracts out* a business process to another party and may include either or both foreign and domestic contracting. You may be familiar with outsourcing if your college has outsourced the bookstore to a national chain such as Barnes & Noble, or the food services are provided by a company such as Starbucks or Aramark. Although the employees work on your college campus, they are not college employees. **Offshoring**, on the other hand, is the actual *relocation* of a business process from one country to another—typically it's an operational process, such as manufacturing, or sometimes a supporting process, such as accounting. In the case of offshoring, the employees still work for the company that's offshoring its operations, but instead of working in a facility within the United States, they are located in a foreign country. In general, outsourcing and offshoring are strategies that companies use to try to lower their costs.

If a business chooses outsourcing as a way to engage with the global market, it might have a single component part manufactured in, say, Tibet and then shipped back to Iowa, where the factory workers in Iowa would use the outsourced part in the assembly of the final product. The business would have a contract with the company making the component part at an agreed-upon price, but it would not have an employer-employee relationship with the workers in Tibet. On the other hand, if the business wants to take advantage of offshoring, it would move the entire plant from Iowa to Tibet and hire workers in Tibet who would work directly for the business.

The following video is an example of how a small business is outsourcing its manufacturing to China. Especially for small start-up companies, using established manufacturing facilities located outside of the U.S. allows them to enter the global marketplace. Cost, logistics, finances, and speed are just some of the things that this type of arrangement can bring to businesses looking to take advantage of the growing global demand for U.S.-branded products.



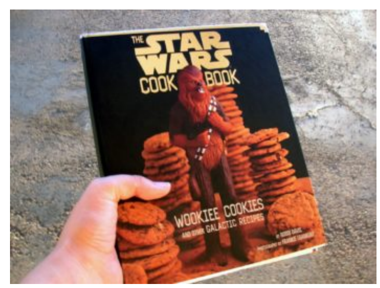
Advantages and Disadvantages

Offshoring and outsourcing are both the subject of ongoing heated public debate—both in the U.S. and in other countries. Those in favor assert that these strategies benefit both sides of the arrangement: Free trade is enhanced, the destination country gains jobs, and the origin country gets cheaper goods and services. Some supporters go further and assert that outsourcing and offshoring raise the gross domestic product (GDP) and increase the total number of jobs domestically, too. This claim is based on the idea that workers who lose their jobs will move to higher-paying jobs in industries where the origin country has a comparative advantage.

On the other hand, job losses and wage erosion “at home” have sparked opposition to offshoring and outsourcing. Many argue that the jobs that are shipped overseas are not replaced by better, higher-paying ones. And it’s not just low-skilled workers who are feeling the pain. Increasingly, critics say, even highly trained workers (such as software engineers) with high-paying jobs are finding themselves replaced by cheaper workers in India and China. Some firms, while realizing financial gains from lowering their production costs, are finding that offshoring and outsourcing are very costly in terms of lack of control over product quality, working conditions, and labor relations. For example, companies like Nike and Apple have come under fire by human rights organizations and consumers over reports of worker abuse, dangerous working conditions, and ridiculously low wages. It was recently reported that apparel workers in Bangladesh are sometimes paid as little as $0.21 per hour. We will explore some of the ethical issues raised by offshoring and outsourcing later in the course in the business ethics module.

Licensing and Franchising

Figure 14.4.3 The Star Wars Cookbook



Increasingly, businesses are getting their products and services into global markets via licensing and franchise agreements. Under a **licensing agreement**, the licensor agrees to let someone else (the licensee) *use* the property of the licensor in exchange for a fee. License agreements usually cover property that is intangible, such as trademarks, images, patents, or production techniques. Since its debut in the late 1970s, *Star Wars* remains the most lucrative source of licensing in the entertainment business, generating more than $42 billion from the sale of licensed merchandise.

A longer-term and more comprehensive way to access the global market is through franchising. Under the terms of a franchise agreement, a party (franchisee) acquires access to the knowledge, processes, and trademarks of a business (the franchisor) in order to sell a product or service under the business’s (franchise’s) name. In exchange for the franchise, the franchisee usually pays the franchisor both initial and annual fees. McDonald’s, Holiday Inn, Hertz Car Rental, and Dunkin’ Donuts have all expanded into foreign markets through franchising.

Advantages and Disadvantages

Licensing and franchising both offer advantages for the involved parties: The licensee and franchisee both gain a competitive advantage in the market. The licensee/franchisee gets immediate brand recognition and may quickly overtake the competition by offering a product or service for which there is existing unmet demand. For example, a local sandwich shop may have a hard time competing when a Subway franchise opens because the brand is so well known. Also, because franchises are usually “turnkey” operations in which processes, supply chains, training, and products are already in place, the new business can quickly begin efficient and profitable operations. For the franchisor, this arrangement enables them to gain inexpensive access to a new market, since the initial cost of the franchise is borne by the franchisee. Under a licensing agreement, all of the costs of production, sales, and distribution are the responsibility of the licensee. If financial capital is scarce, both approaches allow companies to have a global presence without heavy investments.

These methods do contain some risks and disadvantages, however. They are typically the least profitable way of entering a foreign market, since the profits go to the franchisee or licensee. Although the licensor or franchisor receives up-front money and/or a small percentage of future sales, the majority of the revenue remains in the destination country with the licensee or franchisee. Franchising entails a long-term commitment on the part of the franchisor to provide ongoing support in the form of training, logistics, product development, and brand marketing. Once a business begins to establish a global franchise presence, the pressure to maintain brand integrity and fiscal responsibility becomes more intense as the failure of the franchise now has global consequences. For companies selling licensing rights there is a risk that their intellectual property may be misrepresented or used in a manner that could tarnish the brand's image. Also, once a license to use an image or other intellectual property has been granted to a company in another country, the probability that knock-off products will enter the market goes up. For both franchisors and licensors, maintaining quality standards on a global scale is a massive undertaking, and for this reason many companies are choosing to exert a higher degree of control over their products, brands, and intellectual property than they have in the past.

Joint Ventures/Strategic Alliances

Figure 14.4.4 Honey Nut Cheerios

There are times when businesses have opportunities within the global market that are better undertaken with a partner. Sometimes these projects are extremely large and capital-intensive or are so comprehensive that it makes sense to include multiple businesses or even governments. These large-scale, global projects usually take one of two forms: strategic alliances or joint ventures.

A **joint venture** establishes a new business that is jointly owned by two or more otherwise independent businesses. The most common joint ventures involve two companies that are equal partners in the new firm, investing money and resources while sharing control of the newly formed firm. Often, the foreign partner provides expertise on the new market, business connections and networks, and access to other in-country aspects of business such as real estate and regulatory compliance. For example, in 2015 Fiat Chrysler entered into a joint venture with Tata Motors of India to expand the production of Jeeps in India. The company created in this joint venture is Fiat India Automobiles Private Limited.

Joint ventures require a greater commitment from firms than other global strategies, because they are riskier and less flexible. Joint ventures may afford tax advantages in many countries, particularly where foreign-owned businesses are taxed at higher rates than locally owned businesses. Some countries require all business ventures to be at least partially owned by domestic business partners.

A less permanent, but equally effective way to enter the global market is through a **strategic alliance**. A strategic alliance is formed between two or more corporations, each based in their home country, for a specified period of time. Unlike a joint venture, a new company is not formed. Generally, strategic alliances are pursued when businesses find that they have gained all they can from exporting and want to expand into a new geographic market or a related business. This approach can be particularly useful when a government prohibits imports in order to protect domestic industry. The cost of a strategic alliance is usually shared equitably among the corporations involved, and it's generally the least expensive way for all concerned to form a partnership. An example of this is the alliance between General Mills and Nestlé: Honey Nut Cheerios are manufactured in bulk by General Mills in the United States and then shipped to Nestlé Europe, where they are packaged and shipped to France, Spain, and Portugal.

Advantages and Disadvantages

The greatest advantage of joint ventures and strategic alliances is the knowledge and experience of the market offered by the local partner—on everything from consumer preferences to cultural differences, language, and political/economic systems. Another advantage is that the risk of entering the market with a new product is shared by more than one firm, thereby reducing each company's exposure to potential losses.

However, these types of partnerships also have their drawbacks. When companies share their technology and industry know-how, they run the risk that the partner firm will take that technology or innovation and use it to become a competitor in the future. This was a primary concern when Boeing collaborated with Mitsubishi (it was ultimately resolved in the legal details of the partnership agreement, which both companies signed). Conflicts over control of these partnerships can also arise if the owners of the partner firms do not agree on key business decisions.

Figure 5. BMW US Manufacturing Company, South Carolina

Of all of the ways that a business can reach the global market, the most intensive approach is through foreign direct investment or FDI. **Foreign direct investment** is an investment in the form of a controlling ownership in a business enterprise in one country by an entity based in another country. FDI can take one of two forms: Greenfield ventures or mergers/acquisitions.

In a Greenfield venture, the company enters a foreign market and establishes a new subsidiary as a start-up business. A good example of this is the BMW US Manufacturing Company, a vehicle-assembly facility located in Greer, South Carolina, that is part of the BMW Group. Although it's BMW's only assembly plant in the United States, it represents a direct investment inside the United States by the German manufacturer, and it's one of the most successful Greenfield ventures in the U.S.

Businesses that are not ready to take on the challenge of establishing a new facility or subsidiary in a foreign country will usually choose either a merger or acquisition as a means of expanding their global reach. Mergers and acquisitions represent the vast majority of FDI and range from 50 percent to 80 percent of all FDI in some industries. According to *Forbes*,

> *"U.S. companies completed 116 emerging market acquisitions in the first half of 2013, up from 110 in the second half of 2012. . . . The most popular geographic targets for U.S. companies in the first half of 2013 were Brazil (25 deals), India (18 deals), South American countries excluding Brazil (15), South and East Asia (15), and Central America and Caribbean (14).[2]"*

Mergers and acquisitions aren't just carried out by U.S. companies, either—it's an incredibly pervasive global business strategy, and ownership of many well-known products and brands has long been separated from the country of origin. For example, the Chinese just bought Smithfield Foods, Stolichnaya ("Stoli") Russian vodka is actually owned by a company in the United Kingdom, Anheuser-Busch is owned by Belgian-Brazilian conglomerate InBev, and 7-Eleven is owned by the Japanese.[3]

Advantages and Disadvantages

Because the level of commitment and investment associated with FDI is so high, companies expend a great deal of time and effort scrutinizing potential opportunities. With Greenfield ventures, the amount of time it takes to build a presence in the foreign country is substantial. If a business is not already established in other global locations and lacks experience with FDI, it may be in for a series of unpleasant surprises in the form of regulations, licensing, taxes, and other "red tape"—much of which we will look at later in this module.

On the other hand, mergers and acquisitions are faster to execute than Greenfield ventures, and by merging with or acquiring an existing foreign company already in the market, outside companies can quickly take advantage of that presence. Another benefit is that a merger or acquisition involves the purchase of assets such as property, plants, and equipment that are already producing a product with a known revenue stream. The key to a successful merger or acquisition is paying the right price for the company, because, no matter how successful the business was before it was acquired (or merged), overpaying can turn a formerly profitable operation into a money pit.

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