

6.38: Pitfalls in Globalizing a Management Model

Globalizing a company's management model is hard. As firms increase their revenue by expanding into more countries and by extending the lives of existing products by bringing them into emerging markets, costs can often be reduced through global sourcing and better asset utilization. But capitalizing on such profit opportunities is hard because every opportunity for increased globalization has a cost and carries a danger of actually reducing profit. For example, the company's customer focus may blur as excessive standardization makes products appeal to the lowest common denominator, alienating key customer segments and causing market share to fall. Or a wrong globalization move makes innovation slow down and causes price competition to sharpen.

The best executives in a worldwide firm are often country managers who are protective of "their" markets and value delivery networks. Globalization shrinks their power. Some rise to new heights within the organization by taking extra global responsibilities; some leave. Many fight globalization, making it tough for the CEO. Sometimes they win and the CEO loses. Overcoming organizational resistance is therefore key to success.

Minicase: When Global Strategy Goes Wrong (Huggett (2002, April 4)).

In April of 2002, Japan's leading mobile operator, NTT DoCoMo, Inc., announced it would write down the reduced value of its investment in AT&T Wireless Services, Inc., a move expected to contribute to an extraordinary loss of about 1 trillion yen (\$7.53 billion) for the fiscal year. And when the full extent of the write-downs of all its recent European, U.S., and Asian investments was realized, the bill for the ambitious globalization strategy pursued by Japan's—and Asia's—most valuable company exceeded \$10 billion.

NTT DoCoMo clearly had the cash flow from its domestic business to avoid, by a long way, the high-profile fate of now bankrupt Swissair. However, the two companies' approaches to global strategy provide interesting parallels and lessons for other international players in all industries. NTT DoCoMo and the former Swiss flag carrier enjoyed strong economic success built around a former monopoly and highly protected incumbent positions in their home markets. NTT DoCoMo was the clear leader in the Japanese mobile market, with a 60% market share that drove an annual operating cash flow of more than \$10 billion. Swissair's dominant carrier position delivered financial performance that was similarly blue chip.

But a strong domestic market position and excess cash flow do not guarantee success abroad. In fact, without a quite sophisticated understanding of the uniqueness of its domestic situation, a strong domestic position could conceal some of the risks of a global strategy. The first lesson is one of microeconomics: understand what drives superior economic performance in a particular business and do not take domestic success for granted. Both the airline and the telecommunications businesses are highly regulated, technology-driven, and capital-intensive industries with high fixed and very low marginal costs (per airline seat or per mobile-call minute). Rapid changes in regulation and technology are changing some of the rules of the game but not the basic economics of either of these businesses.

In the airline industry, cost advantages are driven by an airline's dominance in airport hubs and on specific routes. The airline with the most flights in and out of a specific airport generates lower unit costs per flight and per passenger than competitors. The airline with the highest market share and flight frequency on a given route typically has lower costs per seat, higher utilization, and superior pricing power. In the mobile industry, the significant fixed-cost components of the business (networks, product development, and brand advertising and promotion) provide unit cost advantages to the national market leader compared with its followers.

The second lesson from NTT DoCoMo and Swissair's experience is to have a clear view of the real economic boundaries of your business—is it a global business or, rather, a multilocal or regional one? Sitting on increasing cash balances, both DoCoMo and Swissair saw a high volume of merger and acquisition activity. They concluded a wave of "globalization" was underway in their industries and that they could not afford to be left out. The result: they developed growth aspirations beyond their national boundaries.

But while regulatory changes allowed increased foreign shareholdings in telecommunications and airlines opened up new international investment opportunities, they have not changed the laws of economics. Despite regulatory changes, the economics of the mobile-phone industry remain primarily national or regional in nature. This implies that it is better to be a market leader in one country than a follower in two countries. Similarly, regulatory changes in traditional, bilateral air-transport agreements have shifted barriers to entry and hence increased competition and reduced pricing power in the airline industry, but they have not changed its fundamental economics. All successful airline mergers have been driven around

building or expanding hub or route dominance, not around building sheer, absolute scale in terms of either aircraft or destinations served

When both NTT DoCoMo and Swissair convinced themselves they needed to expand beyond domestic boundaries to survive, the race to fulfill their global aspirations seems to have resulted in a set of investments more focused on the number of flags on a boardroom map rather than on these basic economics driving superior profitability in their industries. The risks of these two aggressive expansion strategies were further compounded by not having control over most of their international investments. This suggests a third lesson: move to management control if you are serious about capturing acquisition synergies.

During the mid to late 1990s, Swissair kept its investment bankers busy with a nonstop string of deals. The company adopted an explicit “hunter strategy,” which led to acquisitions of noncontrolling minority stakes in a string of strategically challenged nonincumbent carriers: German charter carrier LTU, the French airlines AOM-Air Liberte and Air Littoral, and Italy’s Volare Airlines and Air Europe. In addition, Swissair acquired stakes in Polish flag carrier LOT, Belgium’s Sabena, and South African Airways.

Without majority control, there was very limited scope for Swissair management to drive the economic benefits from these airline shareholdings through route consolidation, aircraft fleet rationalization and purchasing benefits. In addition, there was no ability to take corrective action when operational or financial performance deteriorated.

Similarly, in short order, DoCoMo accumulated direct or indirect stakes in nine mobile operators—most for cash—at the peak of the telecom bubble. But this acquisition spree resulted in equity stakes in only two market leaders, and these were in relatively minor geographic markets: KPN Mobile domestically in the Netherlands and Hutchison in Hong Kong. All the others were lesser players. DoCoMo acquired stakes in the No. 3 U.S. player, AT&T Wireless; Taiwan’s No. 4 player, KG Telecom; the United Kingdom’s No. 5 player, Hutchison U.K., and distant followers KPN Orange in Belgium and E-Plus in Germany. Worse still, all these investments were minority stakes and so gave DoCoMo limited ability to exert control over critical strategic and operational issues at these operators.

This page titled [6.38: Pitfalls in Globalizing a Management Model](#) is shared under a [CC BY-NC-SA](#) license and was authored, remixed, and/or curated by [Anonymous](#).

- [10.1: Pitfalls in Globalizing a Management Model](#) by Anonymous is licensed [CC BY-NC-SA 3.0](#). Original source: <https://2012books.lardbucket.org/books/global-strategy>.