

## Agenda

- Conflicting Pressures to Globalization
- AAA Strategy *Pankaj Ghemawat.*
- Organizational Architecture for Globalization

1

## Conflicting Pressures to Globalization

2

### What Types of Competitive Pressures Exist in the Global Marketplace?

- Firms that compete in the global marketplace face two conflicting types of competitive pressures
  - the pressures limit the ability of firms to realize location economies and experience effects, leverage products, and transfer skills within the firm
- Dealing with both pressures is challenging

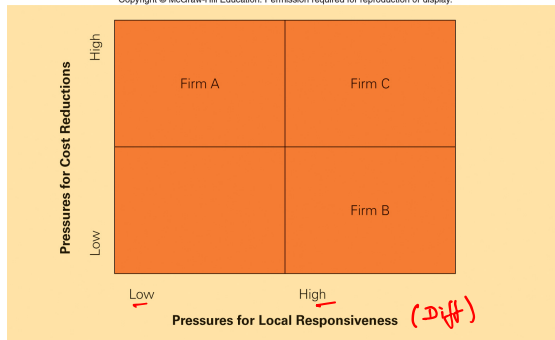
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### What Types of Competitive Pressures Exist in the Global Marketplace?

- Two competitive pressures:
  1. Pressures for cost reductions → *Cost Leadership*
    - force the firm to lower unit costs
  2. Pressures to be locally responsive
    - require the firm to adapt its product to meet local demands in each market
      - but, this strategy can raise costs → *Differentiation.*

4

### What Types of Competitive Pressures Exist in the Global Marketplace?



5

### When Are Pressures for Cost Reductions Greatest?

*Lacometive.*

- Pressures for cost reductions are greatest
- 1. In industries producing commodity-type products that fill **universal needs** (needs that exist when the tastes and preferences of consumers in different nations are similar if not identical) where price is the main competitive weapon
- 2. When major competitors are based in low cost locations
- 3. Where there is persistent excess capacity
- 4. Where consumers are powerful and face low switching costs

6

### When Are Pressures for Local Responsiveness Greatest?

*McDonalds.*

- Pressures for local responsiveness arise from
- 1. Differences in consumer tastes and preferences
  - strong pressure emerges when consumer tastes and preferences differ significantly between countries
- 2. Differences in traditional practices and infrastructure
  - strong pressure emerges when there are significant differences in infrastructure and/or traditional practices between countries

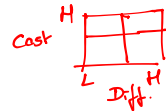
7

### When Are Pressures for Local Responsiveness Greatest?

- 3. Differences in distribution channels
  - need to be responsive to differences in distribution channels between countries
- 4. Host government demands
  - economic and political demands imposed by host country governments may require local responsiveness

8

## Which Strategy Should a Firm Choose?

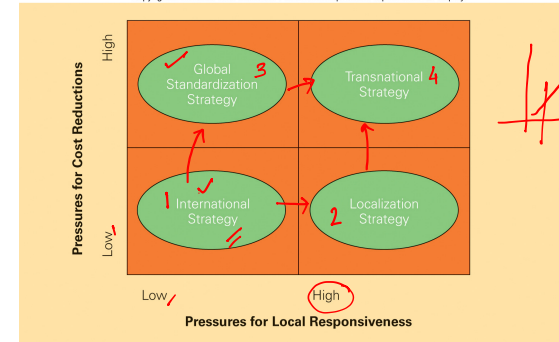


- There are four basic strategies to compete in international markets
- the appropriateness of each strategy depends on the pressures for cost reduction and local responsiveness in the industry

9

## Which Strategy Should a Firm Choose?

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10

## Which Strategy Should a Firm Choose?

1. **Global standardization** - increase profitability and profit growth by reaping the cost reductions from economies of scale, learning effects, and location economies
  - goal is to pursue a low-cost strategy on a global scale
- This strategy makes sense when
  - there are strong pressures for cost reductions and demands for local responsiveness are minimal

11

## Which Strategy Should a Firm Choose?

2. **Localization** - increase profitability by customizing goods or services so that they match tastes and preferences in different national markets
- This strategy makes sense when
    - there are substantial differences across nations with regard to consumer tastes and preferences and cost pressures are not too intense

12

### Which Strategy Should a Firm Choose?

- 3. **Transnational** - tries to simultaneously achieve low costs through location economies, economies of scale, and learning effects
  - firms differentiate their product 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
- This strategy makes sense when
  - both cost pressures and pressures for local responsiveness are intense

13

### Which Strategy Should a Firm Choose?

- 4. **International** – take products first produced for the domestic market and sell them internationally with only minimal local customization
  - This strategy makes sense when
    - there are low cost pressures and low pressures for local responsiveness

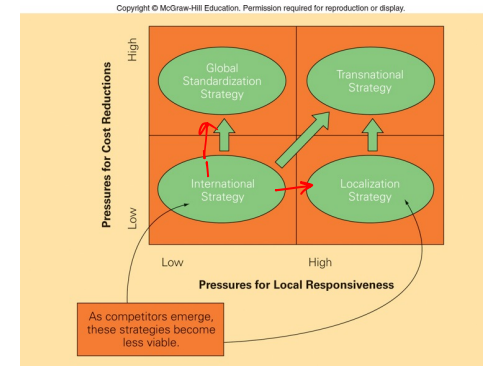
14

### How Does Strategy Evolve?

- An international strategy may not be viable in the long term
  - to survive, firms may need to shift to a global standardization strategy or a transnational strategy in advance of competitors
- Localization may give a firm a competitive edge, but if the firm is simultaneously facing aggressive competitors, the company will also have to reduce its cost structures
  - would require a shift toward a transnational strategy

15

### How Does Strategy Evolve?



16

AAA strategy

17

### Strategy

Strategy	Adaptation	Aggregation	Arbitrage
<b>Competitive advantage:</b> (Why should we Globalize?)	Market Seeking	Efficiency Seeking	Resource Seeking

18

### Ownership

Strategy	Adaptation	Aggregation	Arbitrage
<b>Competitive advantage:</b> (Why should we Globalize?)	Market Seeking	Efficiency Seeking	Resource Seeking
<b>Ownership:</b> (What should be the entry strategy?)	Export; Licensing; Franchising	Contract manufacturing, Wholly owned subsidiary	Joint venture, Strategic alliance

19

### Location

Strategy	Adaptation	Aggregation	Arbitrage
<b>Competitive advantage:</b> (Why should we Globalize?)	Market Seeking	Efficiency Seeking	Resource Seeking
<b>Ownership:</b> (What should be the entry strategy?)	Export; Licensing; Franchising	Contract manufacturing, Wholly owned subsidiary	Joint venture, Strategic alliance
<b>Location:</b> (Where should we locate operations?)	Mainly in foreign countries that are similar to home base to reduce impact of CAGE distances		In more diverse set of countries to exploit element of distance

20

## Internalization

Strategy	Adaptation	Aggregation	Arbitrage
<b>Competitive advantage:</b> (Why should we Globalize?)	Market Seeking	Efficiency Seeking	Resource Seeking
<b>Ownership:</b> (What should be the entry strategy?)	Export; Licensing; Franchising	Contract manufacturing, Wholly owned subsidiary	Joint venture, Strategic alliance
<b>Location:</b> (Where should we locate operations?)	Mainly in foreign countries that are similar to home base to reduce impact of CAGE distances		In more diverse set of countries to exploit element of distance
<b>Internalization:</b> (How should we be involved?)	<b>Local responsiveness:</b> Local relevance through national focus	<b>Transnational:</b> Vertical integration and horizontal diversification	<b>Cost reduction:</b> Global value chain, Stability of suppliers

21

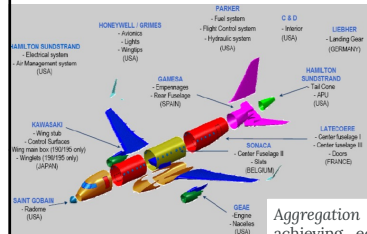
## Adaptation Strategies

Adaptation strategies seek to increase revenues & market share by tailoring one or more components of a company's business model to suit local requirements or preferences.

- Local responsiveness
- Adaptation strategy is subdivided into 5 categories:
  - Variation
  - Focus
  - Externalization
  - Design
  - Innovation

22

## Aggregation Strategies



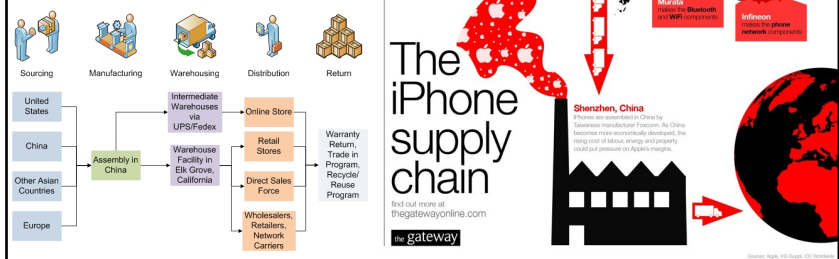
Aggregation strategies focus on achieving economies of scale or scope by creating regional or global efficiencies. These strategies typically involve standardizing a significant portion of the value proposition and grouping together development and production processes.

- Standardization
- Economies of scale/scope

23

## Arbitrage Strategies

- Performance enhancement
- Cost & risk reduction
- Bargaining power of supplier is lowered
- Global supply chain



24

## Which "A" Strategy should a firm use?

• A company's financial statements can guide to the correct "A" strategy.

*Mktg. Sales.*  
*R&D Sales.*  
*Managerial Sales.*

- Firms that heavily rely on branding and that do a lot of advertising, often need to engage in considerable adaptation to local markets.
- Those that do a lot of R&D may want to aggregate to improve economies of scale, since many R&D outlays are fixed costs.
- For firms whose operations are labor intensive, arbitrage will be of particular concern because labor costs vary greatly from country to country.

25

## Which "A" Strategy should a firm use?

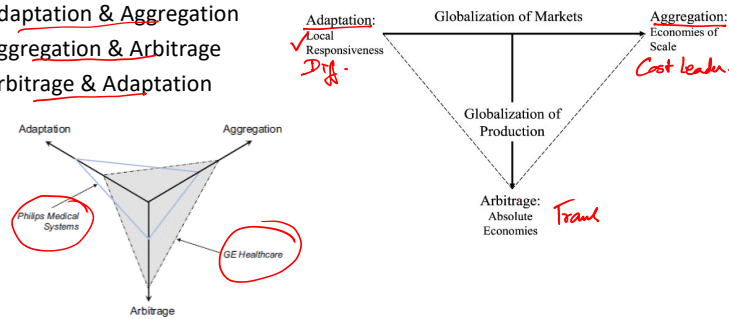
- Which "A" strategy a company emphasizes also depends on its globalization history.
  - Companies that globalize on the supply side, that is, seek to lower cost or to access new knowledge, typically focus on aggregation & arbitrage approaches
  - Companies that globalize by taking their value propositions to foreign markets are immediately faced with adaptation challenges.
- Regardless of their starting point, most companies will need to consider all "A" strategies at different points in their global evolution, sequentially or, sometimes, simultaneously.



26

## From A to AA to AAA

- Adaptation & Aggregation
- Aggregation & Arbitrage
- Arbitrage & Adaptation



27

## From A to AA to AAA

- There are serious constraints on the ability of any one company to simultaneously use all three "A"s with great effectiveness.
  - Such attempts stretch a firm's managerial bandwidth, force a company to operate with multiple corporate cultures, and can present competitors with opportunities to undercut a company's overall competitiveness.
- Most companies would be wise to: *R&D.*
  - focus on one or two of the "A"s
  - make sure the new elements of a strategy are a good fit organizationally
  - employ multiple integration mechanisms
  - think about externalizing integration
  - know when not to integrate.

28

## Where should Marketing and R&D be located?

- **Should the Marketing Mix Be Changed for Each Market?**
  - The current consensus is that while the world is moving towards global markets, global standardization is not possible because of
    - cultural differences among nations
    - economic differences among nations
    - trade barriers
    - differences in product and technical standards
- To adequately commercialize new technologies, firms need to integrate R&D and marketing
  - To successfully commercialize new technologies, firms may need to develop different versions for different countries

29

## How Can Firms Implement Organizational Change?

- To implement organization change
1. Unfreeze the organization through shock therapy
    - requires taking bold actions like plant closures or dramatic structural reorganizations
  2. Move the organization to a new state through proactive change in architecture
    - requires a substantial and quick change in organizational architecture so that it matches the desired new strategic posture
  3. Refreeze the organization in its new state
    - requires that employees be socialized into the new way of doing things

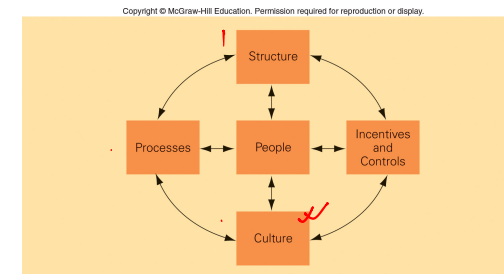
30

## Organizational Architecture for Globalization

31

## What Is Organizational Architecture?

- **Organizational architecture** is the totality of a firm's organization, including



32

## What Is Organizational Architecture?



### 1. Organizational structure

- the formal division of the organization into subunits
- the location of decision-making responsibilities within that structure
  - centralized versus decentralized
- the establishment of integrating mechanisms to coordinate the activities of subunits including cross-functional teams or pan-regional committees

33

## What Is Organizational Architecture?

### 2. Control systems and incentives

- control systems - the metrics used to measure performance of subunits
- incentives - the devices used to reward managerial behavior

34

## What Is Organizational Architecture?

### 3. Processes, organizational culture, and people

- processes - how decisions are made; and work is performed within the organization
- organizational culture - norms and values that are shared among the employees of an organization
- people - the employees and the strategy used to recruit, compensate, and retain employees for their skills, values, and orientation

35

## What Are the Dimensions of Organizational Structure?

- Organizational structure has three dimensions
- 1. Vertical differentiation - the location of decision-making responsibilities within a structure
- 2. Horizontal differentiation - the formal division of the organization into subunits
- 3. Integrating mechanisms - the mechanisms for coordinating subunits



36

## Why Is Vertical Differentiation Important?

- Vertical differentiation determines where decision-making power is concentrated
- **Centralized decision making**
  - facilitates coordination ✓
  - ensures decisions are consistent with the organization's objectives
  - gives managers the means to bring about organizational change
  - avoids duplication of activities

37

## Why Is Vertical Differentiation Important?

- **Decentralized decision making**
  - relieves the burden of centralized decision making
  - has been shown to motivate individuals
  - permits greater flexibility
  - can result in better decisions
  - can increase control

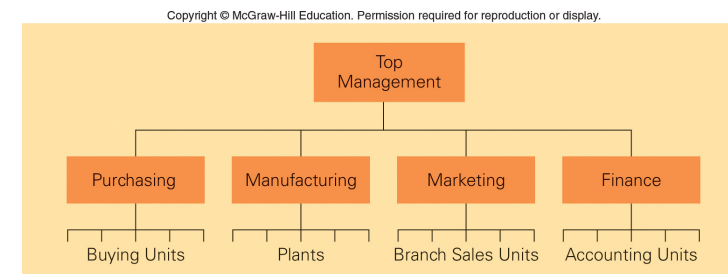
38

## Why Is Horizontal Differentiation Important?

- Horizontal differentiation refers to how the firm ~~divides~~ into subunits
  - usually based on function, type of business, or geographical area
    - finance*
    - Mkt*
    - operations*
- Most firms begin with no formal structure but later split into functions reflecting the firm's value creation activities - **functional structure**
  - functions are coordinated and controlled by top management
  - decision making is centralized
  - product-line diversification requires further horizontal differentiation

39

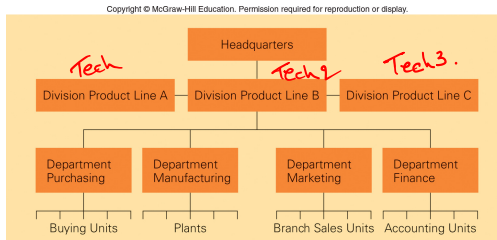
## What Is a Functional Structure?



40

## What Is a Product Divisional Structure?

- Firms may switch to a **product divisional structure**
- each division is responsible for a distinct product line
- headquarters retains control for the overall strategic direction of the firm and for the financial control of each division



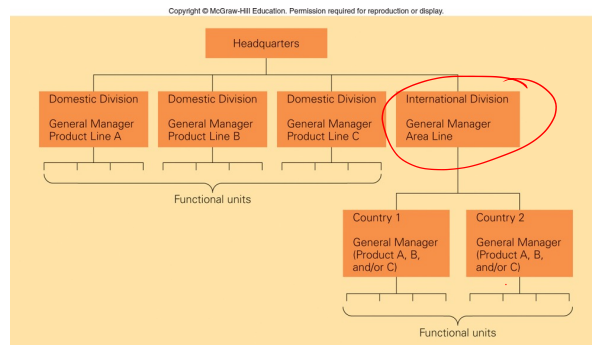
41

## What Happens When Firms Expand Globally?

- When firms expand internationally, they often group all of their international activities into an **international division**
- Over time, manufacturing may shift to foreign markets
  - firms with a functional structure at home would replicate the functional structure in the foreign market
  - firms with a divisional structure would replicate the divisional structure in the foreign market
- In either case, there is the potential for conflict and coordination problems between domestic and foreign operations

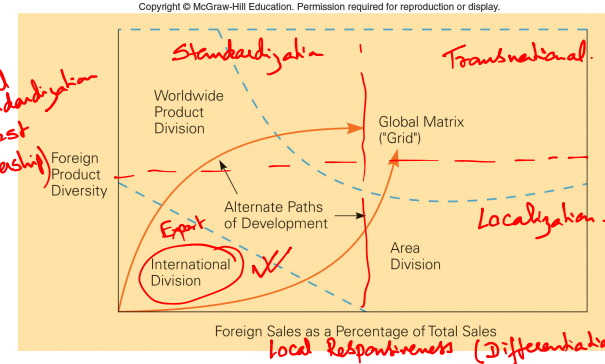
42

## What Is an International Division Structure?



43

## How Does Organizational Structure Change over Time?



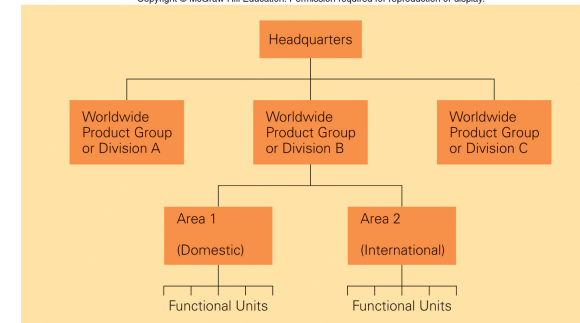
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## What Happens Next?

- Firms that continue to expand will move to either a
- 1. **Worldwide product division structure** - adopted by firms that are reasonably diversified
  - allows for worldwide coordination of value creation activities of each product division
  - helps realize location and experience curve economies
  - facilitates the transfer of core competencies
  - does not allow for local responsiveness

45

## What Is a Worldwide Product Division Structure?



46

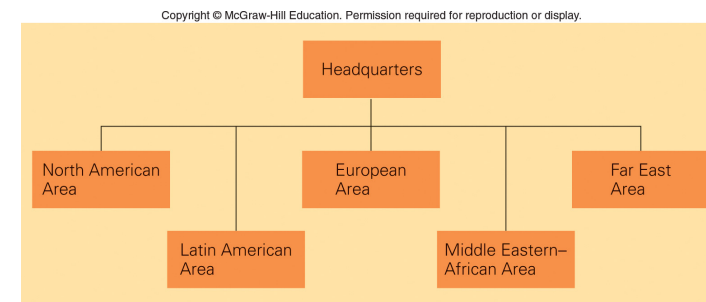
## What Happens Next?

- 2. **Worldwide area structure** - favored by firms with low degree of diversification and a domestic structure based on function
  - divides the world into autonomous geographic areas
  - decentralizes operational authority
  - facilitates local responsiveness
  - can result in a fragmentation of the organization
  - is consistent with a localization strategy

*ITC - BAT.*

47

## What Is a Worldwide Area Structure?



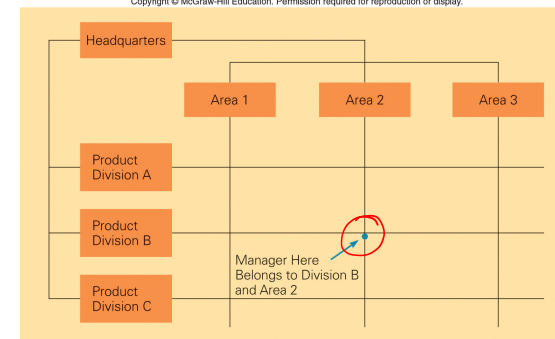
48

## What Is the Global Matrix Structure?

- The **global matrix structure** – tries to minimize the limitations of the worldwide area structure and the worldwide product divisional structure
  - allows for differentiation along two dimensions - product division and geographic area
  - has dual decision making - product division and geographic area have equal responsibility for operating decisions
  - can be bureaucratic and slow
  - can result in conflict between areas and product divisions
  - can result in finger-pointing between divisions when something goes wrong

49

## What Is the Global Matrix Structure?



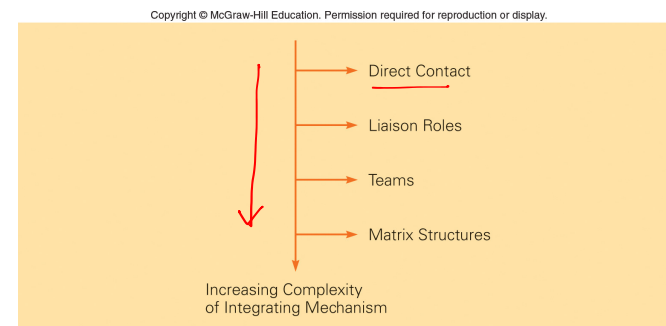
50

## How Can Subunits Be Integrated?

- Regardless of the type of structure, firms need a mechanism to integrate subunits
  - need for coordination is lowest in firms with a localization strategy and highest in transnational firms *Area*
  - coordination can be complicated by differences in subunit orientation and goals
  - simplest formal integrating mechanism is direct contact between subunit managers, followed by liaisons
  - temporary or permanent teams composed of individuals from each subunit is the next level of formal integration
  - the matrix structure allows for all roles to be integrating roles

51

## How Can Subunits Be Integrated?



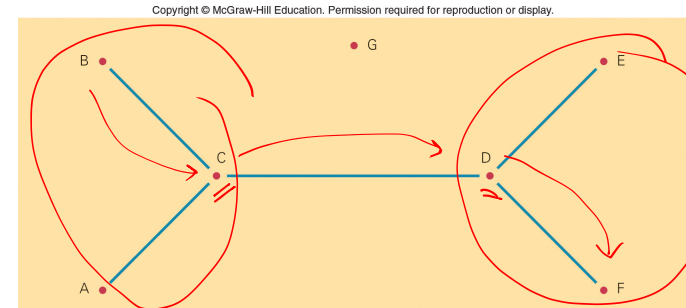
52

## How Can Subunits Be Integrated?

- Many firms use informal integrating mechanisms
- A **knowledge network** - network for transmitting information within an organization that is based not on informal contacts between managers and on distributed information systems
  - a non-bureaucratic conduit for knowledge flows
  - must embrace as many managers as possible and managers must adhere to a common set of norms and values that override differing subunit orientations

53

## How Can Subunits Be Integrated?



54

## What Are the Different Types of Control Systems?

1. **Personal controls** –personal contact with subordinates
  - most widely used in small firms
2. **Bureaucratic controls** –a system of rules and procedures that directs the actions of subunits
  - budgets and capital spending rules

55

## What Are the Different Types of Control Systems?

3. **Output controls** – setting goals for subunits to achieve and expressing those goals in terms of objective performance metrics
  - compare actual performance against targets and intervene selectively to take corrective action
  -
4. **Cultural controls** – exist when employees “buy into” the norms and value systems of the firm
  - strong culture implies less need for other forms of control

56

## What Are Incentive Systems?

- **Incentives** - devices used to reward behavior
  - usually closely tied to performance metrics used for output controls
  - should vary depending on the employee and the nature of the work being performed
  - should promote cooperation between managers in sub-units
  - should reflect national differences in institutions and culture
  - can have unintended consequences

57

## What Is Performance Ambiguity?

- **Performance ambiguity** exists when the causes of a subunit's poor performance are not clear
  - is common when a subunit's performance is dependent on the performance of other subunits
  - is lowest in firms with a localization strategy
  - is higher in international firms
  - is still higher in firms with a global standardization strategy
  - is highest in transnational firms

58

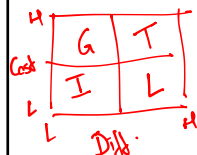
## What Is the Link Between Control, Incentives, And Strategy?

**TABLE 14.1**

Interdependence, Performance Ambiguity, and the Costs of Control for the Four International Business Strategies

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Strategy	Interdependence	Performance Ambiguity	Costs of Control
Localization	Low	Low	Low
International	Moderate	Moderate	Moderate
Global	High	High	High
Transnational	Very high	Very high	Very high



59

## What Are Processes?

- **Processes** refer to the manner in which decisions are made and work is performed
  - many processes cut across national boundaries as well as organizational boundaries
  - processes can be developed anywhere within a firm's global operations network
  - formal and informal integrating mechanisms can help firms leverage processes

60

### What Is Organizational Culture?

- **Organizational culture** - the values and norms that employees are encouraged to follow
- Evolves from JRD
  - founders and important leaders
  - national social culture
  - the history of the enterprise
  - decisions that resulted in high performance

61

### What Is Organizational Culture?

- Organizational culture can be maintained through
  - hiring and promotional practices
  - reward strategies
  - socialization processes
  - communication strategies
- Organizational culture tends to change very slowly

62

### What Is Organizational Culture?

- Managers in companies with a “strong” culture share a relatively consistent set of values and norms that have a clear impact on the way work is performed
- A “strong” culture
  - is not always good
  - may not lead to high performance
  - could be beneficial at one point, but not at another
- Companies with adaptive cultures have the highest performance

63

### What Is the Link Between Strategy And Architecture?

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Structure and Controls	Strategy			
	Localization	International	Global Standardization	Transnational
Vertical differentiation	Decentralized	Core competency more centralized; rest decentralized	Some centralization	Mixed centralization and decentralization
Horizontal differentiation	Worldwide area structure	Worldwide product divisions	Worldwide product divisions	Informal matrix
Need for coordination	Low	Moderate	High	Very high
Integrating mechanisms	None	Few	Many	Very many
Performance ambiguity	Low	Moderate	High	Very high
Need for cultural controls	Low	Moderate	High	Very high

**TABLE 14.2**  
A Synthesis of Strategy, Structure, and Control Systems

*Handwritten notes: A 2x2 grid with 'G' and 'I' in the top row and 'S' and 'L' in the bottom row. 'Cost' is written above the grid and 'Diff' below it. Arrows point from 'Cost' to the grid and from the grid to 'Diff'.*

64

### What Is the Link Between Strategy And Architecture?

1. Firms pursuing a **localization strategy** focus on local responsiveness
  - they do not have a high need for integrating mechanisms
  - performance ambiguity and the cost of control tend to be low
  - the worldwide area structure is common

65

### What Is the Link Between Strategy And Architecture?

2. Firms pursuing an **international strategy** create value by transferring core competencies from home to foreign subsidiaries
  - the need for control is moderate
  - the need for integrating mechanisms is moderate
  - performance ambiguity is relatively low and so is the cost of control
  - the worldwide product division structure is common

66

### What Is the Link Between Strategy And Architecture?

3. Firms pursuing a **global standardization strategy** focus on the realization of location and experience curve economies
  - headquarters maintains control over most decisions
  - the need for integrating mechanisms is high
  - strong organizational cultures are encouraged
  - the worldwide product division is common

67

### What Is the Link Between Strategy And Architecture?

4. Firms pursuing a **transnational strategy** focus on simultaneously attaining location and experience curve economies, local responsiveness, and global learning
  - some decisions are centralized and others are decentralized
  - the need for coordination and cost of control is high
  - an array of formal and informal integrating mechanism are used
  - a strong culture is encouraged
  - matrix structures are common

68