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O. M. BEKETOV NATIONAL UNIVERSITY
of URBAN ECONOMY in KHARKIV

METHODOLOGICAL GUIDELINES
for practical and independent work
on the subject

"INTERNATIONAL BUSINESS STRATEGIES"

(for 4th-year full-time students education level "Bachelor"
specialty 073 – Management)

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Content module 1. Concept of International Business Strategies

Topic 1. Conceptual foundations of International Business Strategies.

Seven concepts of IBS

Seven concepts form a unifying framework that constitutes the essence of international business strategy, and reflects the foundations of global corporate success:

1. Internationally transferable (or non-location-bound) firm-specific advantages (FSAs).
2. Non-transferable (or location-bound) FSAs.
3. Location advantages.
4. Investment in – and value creation through – recombination.
5. Complementary resources of external actors (not shown explicitly in figure).
6. Bounded rationality.
7. Bounded reliability.

1 Internationally transferable (or non-location-bound) firm-specific advantages (FSAs)

Internationally transferable FSAs and the four MNE archetypes:

The MNE creates value and satisfies stakeholder needs by operating across national borders. When crossing its home country border to create value in a host country, the MNE is, almost by definition, at a disadvantage as compared to firms from the host country, because these firms possess a knowledge base that is more appropriately matched to local stakeholder requirements. The MNE incurs additional costs of doing business abroad, resulting from cultural, economic, institutional and spatial distance between home and host country environments.

MNE managers often find it particularly difficult to anticipate the liability of foreignness resulting from the cultural and institutional differences with their home country environments, even though these may be reduced over time as the firm learns and gains increased legitimacy in the host country.

In order to overcome these additional costs of doing business abroad, the MNE must have proprietary internal strengths, such as technological, marketing or administrative (governance-related) knowledge. This set of MNE internal strengths, the availability of which both allows and constrains the scope of the firm's expansion across borders, is called the internationally transferable, or non-location-bound, FSAs. These FSAs do not stop creating value when the border is crossed between the home and the host country, though their precise value may be somewhat different in the two countries. In principle, the MNE can deploy and exploit these FSAs successfully across borders. Non-location bound FSAs can be embodied in final products, for example when the MNE exports goods and services that are valued highly by host country customers.

Perhaps the most important bundle of tacit knowledge is contained in the MNE's administrative heritage: the key routines developed by the firm since its inception. These are often determined by the vision of the founder and the firm's particular set of external circumstances ('this is the way we do things in this company'). At a general level, we can distinguish among four archetypes of administrative heritage, each associated with a specific routine of international FSA transfer.

First, the ***centralized exporter***: this home-country-managed firm builds upon a tradition of selling products internationally, out of a limited number of (scale-efficient) facilities in the home country, and with only minor, usually customer-oriented, value-creating activities abroad. ***Standardized products manufactured at home embody the firm's FSAs (themselves developed on the basis of a favourable home country environment, including local clustering) and make the exporting firm successful in international markets.*** The foreign subsidiaries act largely as facilitators of efficient home country production.

Multinational activities occur primarily in the downstream end of the value chain, and are related to marketing, distribution and related logistics operations.

Many large Japanese MNEs have this type of heritage. They became serious about international expansion in the 1960s, in an era of declining trade barriers, communication and transport costs. For example, the introduction of the container as a

cargo unit in maritime transport in the mid sixties greatly facilitated international trade in manufactured goods.

Case example. *Nippon Electric Limited Partnership (NEC), established in 1899.*

In 1929, NEC developed the A-type switching system, the first of this type of radio communication systems, and supplied it to Japan's Ministry of Communications. In 1939, NEC established a fullfledged research laboratory, leading to successful new product development, including the first crossbar switching system adopted in Japan.

NEC's international expansion was characterized by the export of products that had already been successful domestically. As early as 1934, NEC provided the Chinese Xinjing station with a radio broadcasting system. However, extensive international expansion only started in the 1960s, when sales subsidiaries such as NEC de Mexico, NEC do Brasil, NEC Australia and NEC Electronics (Europe) were established. At that stage, NEC also exported satellite communication systems to the US, Switzerland, China, etc. NEC started to open foreign plants during the socalled 'C&C' era. C&C refers to the integration of computers and communications technologies from 1978 to 1989. This expansion included a telephone systems plant in the US and a VLSI (Very Large Scale Integration) plant in the UK, capable of placing hundreds of thousands of electronic components on a single chip. At present, manufacturing is geographically dispersed: NEC has 54 plants in Japan, including five plants in or near Tokyo, and 58 manufacturing plants overseas, meaning that NEC is no longer a 'pure' centralized exporter.

In spite of its extensive international operations, NEC still functions with strongly centralized domestic R&D capabilities, which are the source for most of its new products. In 2005, it had nine domestic R&D laboratories staffed with 1,800 employees. Although six laboratories were located abroad, these had only 200 employees in total. The domestic concentration of formal new knowledge development suggests the continued relevance of the firm's longstanding administrative heritage as a centralized exporter.

Case example. *Motion picture studios are typical centralized exporters, and thus their final products incorporate all of the companies' FSAs. Motion pictures are*

typically exported from the place where they are created. Warner Bros. Pictures, a major US motion picture studio, has done very well in attracting foreign customers. Through its international offices in more than 30 countries, the company distributes films to more than 175 territories outside of North America. In 2004, its worldwide box office revenues reached $3.41 billion, with $2.19 billion coming from overseas. As one typical example of the importance of foreign markets, in the debut weekend of its 2004 film Harry Potter and the Prisoner of Azkaban, the company grossed $93.7 million in North America versus $113.5 million in 24 countries abroad.

The second archetype of administrative heritage is the ***international projector***: this firm builds upon a tradition of transferring its proprietary knowledge developed in the home country to foreign subsidiaries, which are essentially clones of the home operations. Many American MNEs fit this model, as they expand internationally based upon a large and sophisticated home country market, as well as proprietary technology and unique management practices. ***Knowledge-based FSAs developed in the home country are transferred to subsidiaries in host countries. The international projector MNE seeks international expansion by projecting its home country success recipes abroad.*** To the extent that international projection requires the systematic and continuous transfer of tacit knowledge to multiple locations (particularly when the product offering contains a large service component), this firm relies on an extensive cadre of professional managers who can act as expatriates or repositories/transfer agents of the home country success recipes.

Case example. *The American automobile manufacturer Ford is a well-known example of a firm with an administrative heritage dominated by international projection. Ford, established in 1903, rapidly started to export cars to Canada and Europe through export agents.*

In Canada, for example, Ford essentially cloned its American operations. In 1904, Gordon McGregor, a Canadian from Walkerville, Ontario, suggested the creation of a new company to manufacture the Model A in Canada. The anticipated significant tariff savings and new capability of rapid response to Canadian demand, as well as local financing possibilities, motivated Ford to sign the agreement that

established Ford Canada. Ford agreed to 'furnish it with patents, plans, drawings, and specifications needed to build automobiles', but Ford United.

States would retain control of Canadian operations, with 51 per cent of equity.

As a latecomer in internationalization as compared to the Olds Motor Company and the Cadillac Automobile Company, Ford benefited from strengths in the extensive use of machine tools as compared with the European automakers, but also faced the challenge of widespread prejudice against American cars sold in Europe.

At first, Ford exported to Great Britain through agents. Ford did not bear any duties on automobiles exported to Britain, and its low prices helped its expansion into the British market. However, other European countries imposed protective import duties, and this complicated business. The rising sales in Britain, especially with the introduction of the Model T, made it attractive to establish an assembly plant in Britain, in order to reduce shipping and other transaction costs associated with exports. The Ford Motor Company Ltd (England) was established in March 1911. The manufacturing plant in Manchester followed the American production pattern almost exactly, with obvious exceptions such as right-hand drive: 'Variations at the factory were rare', and 'in production and purchasing techniques the resemblance between Manchester and Detroit was also close'.

By 1921, Ford had opened plants in France, Denmark, Ireland and Argentina. All these affiliates operated as branch plants, receiving 'the same general letters of instruction, the same communications about accounting, sales, production, and purchasing'. Marketing was also done according to 'the Ford Bible' emanating from Detroit.

Case example. *Disney opened Disneyland, its first theme park, in Anaheim, California (US), in 1955. The park's success helped the company to open a second theme park, Walt Disney World, in Orlando, Florida (US), in 1971. It then opened Tokyo Disneyland (Japan) in 1983, and Disneyland Paris (France) in 1992. Hong Kong Disneyland opened in 2005.*

Disney is an international projector, and Tokyo Disneyland, Disneyland Paris and Hong Kong Disneyland cloned the original park in Anaheim. For example, except

for some subtle local adaptations, Hong Kong Disneyland mirrored the Anaheim park, 'from Main Street, USA to the Space Mountain roller coaster to Sleeping Beauty's castle'.11 As noted by Wing Chao, Vice-Chairman for the Asia Pacific development of Disney parks: '(T)he Disney American spirit is in the architecture and the whole ambiance . . . We're bringing Disney America . . . to Hong Kong'.12 All the face characters in these international parks are played by 'white actors who speak only English'.

However, planting the US approach in Hong Kong without an in-depth understanding of the Hong Kong situation 'left Mickey Mouse looking like Cinderella's stepmother'. Nasty headlines clouded the opening period. In addition to labour relations problems, a Disney official prevented government food inspectors from entering Disney until they removed their caps and badges to be indistinguishable from other visitors; Hong Kong pop stars filming promotional videos for the park for free were enraged by impolite treatment.

Disney's unfamiliarity with the local culture was exemplified by Disney's failure to host unanticipated larger numbers of visitors during the Chinese New.

Year holidays in late January and early February 2006. Disney sold discounted and undated one-day tickets which allowed holders to visit Disney any time in the next six months except special days designated by Disney. Hong Kong had a four-day public holiday for the Chinese New Year, but mainland China had a oneweek holiday. Disney designated only the Hong Kong public holidays as special days, and failed to anticipate the large number of mainlanders who were brought by Chinese tour agencies. Faced with swelling visitors beyond its size to host, Disney turned away thousands of visitors who had bought tickets. Ultimately, Disney's enragement of its visitors led the Hong Kong government to ask the firm to improve its ticketing.

In September 2006, Hong Kong Disneyland celebrated its first anniversary. Attendance exceeded 5 million, poorer than the expected 5.6 million visitors. Hong Kong Disneyland clearly needs more time to understand fully customers from Hong Kong and mainland China.

The third archetype of administrative heritage is the **international coordinator**: this centrally managed firm's international success does not build primarily on home country FSAs embodied in products exported internationally (as was the case with the centralized exporter), nor does it simply transfer FSAs to foreign subsidiaries to replicate home country success (as was the case with the international projector). The international coordinator builds upon a tradition of managing international operations, both upstream and downstream, through a tightly controlled but still flexible logistics function. **International operations are specialized in specific value-added activities and form vertical value chains across borders. The MNE's key FSAs are in efficiently linking these geographically dispersed operations through seamless logistics.** Many large MNEs in natural resources industries fit this archetype. They search for relevant resources internationally, manufacture in the most cost-efficient locations, and sell their products wherever there is demand for them.

Case example of administrative heritage is the international coordinator. *BP (British Petroleum Ltd) was established as the Anglo-Persian Oil Company in 1909, to develop the oilfield in southwest Persia. Anglo-Persian soon constructed a refinery at Abadan on the Shatt-al-Arab waterway in 1913 and started to sell fuel oil to the British navy. In 1914, the British Government bought a controlling interest in order to ensure an oil supply for the British navy.*

In these early days, the expertise of Anglo-Persian was its ability to link its oil supply in Persia with its customers in Britain. After World War I, however, Anglo-Persian expanded into new markets, building refineries around the world. By 1938 its products were sold in Europe, Africa, the Middle East, India and Australia. However, prior to World War II, Anglo-Iranian (renamed as such in 1935) still had only two major sources for oil: Iraq and Iran.

Over time, BP (renamed The British Petroleum Company in 1954) diversified its sources of oil, finding oil in the UK (the North Sea), the US (Alaska), Abu Dhabi, Australia, Colombia, Kuwait, Norway, Papua New Guinea and Qatar. Today, BP's businesses include a wide variety of activities in exploration and production of crude oil and natural gas; refining and marketing oil and gas; and manufacturing and

marketing petrochemicals. Almost all of the company's activities rely on trans-border coordination. For example, because of the long distances between natural gas fields and many major markets such as the US, UK, Japan and South Korea, BP's liquefied natural gas (LNG) business operates its own vessels as a 'mobile pipeline' to serve its customers. In BP's words: 'LNG bridges the gap: gas is lifted from underground, chilled to liquid, transported on ships from one part of the world to another, and then warmed back into gas to fuel a power plant, factory or home.'

Further, BP also manages long-term, point-to-point contracts to integrate supply coming from specific production sites with demand in specific markets. For example, in Guangdong, China, BP is building an LNG import facility which will be supplied from the North West Shelf project in Australia.

Case example. *Logitech, a firm with a Swiss heritage and the world leading mouse manufacturer, is another international coordinator that has been very effective in coordinating its various operations dispersed around the globe. The company has one manufacturing site in Suzhou (China), many distribution centres in Europe, North America and Asia, and six engineering centres, specializing in different technologies, located in Romanel-sur-Morges (Switzerland), California (US), Hsinchu (Taiwan), Vancouver (Canada), Mississauga (Canada) and Seefeld (Germany).*

To a large extent, Logitech's success depends on the international coordination of its activities. For example, its Swiss engineering centre develops new products in cooperation with several external design partners such as Design Partners, located in Ireland. Designs are sent to Fremont, California (Logitech's operating headquarters), for approval, after which the Hsinchu engineering centre in Taiwan performs pilot runs to check for any potential manufacturing problems.

Finally, the products are moved to Suzhou, China, for high-volume manufacturing, and transported to distributors and large retailers around the world. The distribution centres also perform product localization functions, such as adding local language manuals and software CDs. Similarly, most new products designed at other R&D centres are tested in Hsinchu, Taiwan, manufactured in Suzhou, China, and subsequently shipped to distributors, retailers and consumers.

The fourth and final archetype of administrative heritage is the ***multi-centred MNE***: this firm's international success does not build primarily on knowledge based FSAs developed in the home country. ***The multi-centred MNE consists of a set of entrepreneurial subsidiaries abroad which are key to knowledge-based FSA development. National responsiveness is the foundation of the international strategy. The non-location-bound FSAs that hold these firms together are minimal: common financial governance and the identity and specific business interests of the founders or main owners (typically entrepreneurial families or financial investors).*** Ultimately, the multi-centred MNE should be viewed as a portfolio of largely independent businesses. Many older European MNEs fit this mould. Unlike many of the large Japanese MNEs, these European MNEs expanded internationally before the second half of the twentieth century, in an era of trade, transport and communication barriers. They operated with highly independent local production facilities to satisfy local market needs, and wealthy financial investors provided the required financial resources in an environment of poorly functioning financial markets.

Case example. *In 1891, the two Philips brothers, Gerard and Anton, established the Philips company in order to manufacture incandescent light bulbs in the Netherlands. The small size of the home country soon forced Philips to export its products to foreign countries. In 1921, Philips started to establish sales affiliates in the US, Canada, France, etc.*

However, after World War I, rising trade protectionism also forced Philips to establish factories in countries where it wished to sell. In Europe, most nations imposed import duties and quotas, aiming to protect domestic industry. As a result, Philips expanded its manufacturing operations in Czechoslovakia, Yugoslavia, Romania, Hungary and Poland during this period. Philips ran its affiliates as semiautonomous organizations because high cultural differences among the host countries acted as a major barrier to a more centralized or coordinated approach.

After World War II, the 'daughter companies had become [even] more independent', 18 mainly because the affiliates had continued to operate without much contact between the headquarters and the affiliates during the war.

Consequently, Philips had to decide 'whether to revert to the pre-war system, or to continue on the road which the separate parts had already taken'.19 It decided to stick with the newly established, decentralized course.

In the 1950s, Philips continued to set up new plants as a result of both trade barriers and the need to adapt its products to local conditions. At that stage, it manufactured in more than 50 countries and sold in more than 70. Yet it did not even have any specific department to monitor overseas operations, but only coordinators at the headquarters to maintain connections with the foreign affiliates.

The management board was informed about overseas conditions through both direct reporting from its affiliates and personal travelling by board members all over the world. In 1954, Philips established the International Concern Council, consisting of all the principal managers from around the world and the management board, to review the past year, plan for the future, provide opportunities for personal contacts, arrange promotions, etc.

Case example. *Lafarge Group, a firm with French roots and one of the largest manufacturers of building materials, has largely adopted a multi-centred approach, while also encouraging knowledge sharing within the company.*

The company's official goals are: 'first, to ensure total cohesion within a major multi-national Group present in 75 different countries; and second, to encourage the exchange of best practices, yet leave operating units with a high degree of autonomy'.

To meet these goals, Lafarge is organized into three levels, as a 'multi-local' organization: the corporate level, the divisional level and the business unit level.

'The Corporate level defines the Group's long-term strategies and ensures they are implemented', '[t]he Divisions are responsible for enhancing performance and for the long-term success of their respective business segment' and '[the business unit] most often corresponds to a Division's business segment or to a business segment in a given country or geographical area'. Examples of business units include: Lafarge Gypsum Korea, the Business Unit of the Gypsum Division in South Korea; Fabrica Nacional de Cementos, the Business unit of the Cement Division in Venezuela; Lafarge Bétons, the concrete Business Unit in France; Lafarge Aggregates, the Aggregates

Business Unit in the United Kingdom; and Lafarge Dachsysteme, the Roofing Business Unit in Germany.

Lafarge provides the following rationale for its decentralized organization: 'Each of our businesses is primarily a local business: our products cannot economically be transported over significant distances, construction markets have strong local characteristics, proximity is important to our customers, relationships with local communities are key, and much of our know-how originates from local experience'.

Is the above set of four MNE archetypes a complete set, given the large variety of MNE governance forms in practice? No: although the four archetypes probably describe the bulk of most large MNEs, especially the *Fortune 500* ones, there are other types. ***However, the commonality among all these types is the transfer of at least some FSAs across borders.*** One example from the late nineteenth century, not included in the above archetypes, is that of freestanding companies: companies that were set up abroad – mainly by British and Dutch investors – often in their home country's colonies, without a prior domestic production base. Harrisons & Crosfield, the Hong Kong and Shanghai Bank and Rio Tinto Zinc were all established in this way. These cases went beyond the simple financing of foreign operations (in fact, simple financing, in the sense of portfolio investment, often appeared impossible, given the inefficiency of the capital markets at that time). Here, entrepreneurial judgment and sound (though rather basic) governance were deployed internationally. The prior (macro-level) institutional linking of home and host countries through colonial relationships greatly facilitated this micro-level process. In other words, public policy and institutional convergence greatly reduced the additional costs of doing business abroad, and provided home country entrepreneurs with more direct access to the location advantages of the host countries involved.

The coordination skills of the home country entrepreneurs thereby allowed for the establishment of easy linkages between abundant financial resources and project-management skills in the colonial power and abundant raw materials or cheap labour

in the host country. The focus on coordination suggests at least some similarity with the international coordinator archetype, discussed above.

To the extent that freestanding companies were actually part of larger business networks, the value of entrepreneurial coordination skills and other managerial services (in addition to the obvious value of substituting for imperfect capital markets) was even more apparent.

Whatever archetype an MNE falls under, history suggests that the MNE will usually overestimate the international transferability of its FSAs and the value that can be captured as a result of this transfer. Even when knowledge transfer across borders is achieved rather easily, contextual variables change: first, the forces that reflect extended rivalry (relevant competitors, suppliers, customers, potential entrants and substitutes); second, government regulation and other non-market forces, such as environmental pressure groups; and third, the other relevant stakeholders in the broader business and economic environment.

What may constitute an FSA in the home country – whether a set of distinct stand-alone resources, a routine or even a recombination capability – does not necessarily confer the same value in a foreign context. Whereas upstream resource bundles – such as a superior sourcing system or unique product technology – may have universal, transferable appeal, this usually does not hold for more downstream strengths, where the interface with the customer is key to successful sales and profit performance. Here, substantial investments may be required to allow the deployment and profitable exploitation of the firm's existing FSAs, which may have limited international exploitation potential without such investments. More specifically, if many FSAs developed at home are really location-bound, the MNE's challenge is to develop a new set of location-bound FSAs in host countries that permit successful operations there.

2 Non-transferable (or location-bound) firm-specific advantages

There are four main types of nontransferable FSAs.

First, stand-alone resources linked to location advantages, such as a network of privileged retail locations leading to a dominant market share in the home market (as often found in retail banking), are immobile, and therefore inherently non-transferable. The immobility of domestic networks is a key reason why Japan-based Kao has had only little success in penetrating foreign markets.

Case example. *In 1996, Kao was Japan's largest consumer goods company, with a quarter of the shampoo market, three quarters of the bleach market and half of the laundry detergent market.*

One of the main reasons for Kao's dominant domestic position was its control of a comprehensive distribution system within Japan. Kao owned Hansha, a wholesale distributor, which distributed only Kao's products. As a result, Kao was able to supply small shops easily and also prevent outsiders from entering the market. Moreover, Hansha allowed Kao to gain privileged information on consumers' shopping habits. However, '[I]n Europe and America Kao has failed to build the comprehensive distribution system that it has in Japan'.26 In 1996, around 20 per cent of Kao's sales came from overseas markets; by 2005, the percentage of foreign sales had risen to 30 per cent, in roughly equal shares from America, Europe and Asia/Oceania. Kao has not been able to replicate its domestic success abroad.

Case example. *The immobility of domestic networks has also brought tremendous challenges to many foreign retail banks in Japan, such as Citibank (now Citigroup). Despite its leading position in the US retail banking industry and a large network of branches in the US, Citibank found it difficult to access Japanese customers when it decided to target individual consumers in 1984. It took Citi-Japan a full ten years to break into the Japanese market. According to Citibank, '[R]etail banking . . . is like the petrol-station business: you've got to have your pumps in all the right locations. In Japan, the best spots are hard to get.' In Japan, land prices were extremely high, and building a profitable retail network required large-scale investments and substantial time to establish the network. Moreover, Japanese consumers tended to view foreign banks as less trustworthy than local banks.*

By 1990, Citibank was 'the last of 83 foreign banks in Japan still interested in retail banking'. The number of its retail branches in Japan had grown from 6 in 1985 to 19 in 1993, but it was still a minor player: the smallest Japanese retail bank had 41 branches in 1985.

However, things changed in the mid 1990s, as a result of both Japan's financial turmoil and Citibank's new strategies. In the early 1990s, Citibank hired Masamoto Yashiro from Exxon to head Citi-Japan. With his extensive knowledge of Exxon's retail gas stations, Yashiro saw the need for a large local distribution channel in Japan. Rather than building branches or purchasing a local retailing bank, Yashiro came up with the idea of linking Citi-Japan's financial network with the ATMs of Japanese commercial banks. Although this idea did not come to fruition, Japanese regulators did allow Citi-Japan to affiliate with the Japanese Postal System in 1999. In this way, Citi-Japan gained access to more than 20,000 branches of the Post Office and its ATMs. In return, the Post Office was provided the opportunity to learn about Citi-Japan's funds management capability. This learning was viewed as particularly useful, because the Japanese Post Office was expanding into the banking and insurance business.

When many Japanese banks then encountered severe financial problems, Japanese consumers stopped viewing Citigroup as inferior to Japanese banks. Its affiliation with the Post Office even created the perception that Citigroup was more trustworthy, as the Post Office was widely viewed as the safest institution for deposits in Japan.

Between 1995 and 2000, Citigroup's accounts in Japan rose by 623 per cent. By 1998, it had over a million accounts. In 2001, Citi-Japan's pretax profits reached $540 million, and it expected its deposit base to grow by 25 per cent to 30 per cent a year. This growth has made Citi-Japan a significant competitor for Japanese banking giants.

The second kind of non-transferable FSA: other resources such as local marketing knowledge and reputational resources (e.g., brand names), may not have the same value across borders, either because they are not applicable to a host country

context, or because they are simply not valued to the same extent by foreign stakeholders.

Case example. *We can illustrate the importance of reputational resources with the example of the Polo Ralph Lauren Company, a leading company in so-called 'opulent lifestyle products'. In North America, its brands – such as Polo by Ralph Lauren, Ralph Lauren Purple Label and Black Label – have long been viewed as reflecting a 'classic American gentry style'. In Europe, by contrast, Ralph Lauren has built up a reputation as a high-quality sportswear manufacturer, known for high-quality sports shirts and golf jackets with the distinct Polo logo.*

When the company decided it wanted to expand more rapidly in Europe in 2002, especially by pushing its Purple label brand, representative of its upperclass American style, the difference between its European and American reputational resources became very apparent. According to one leading men's fashion news magazine, 'Europeans see [Ralph] Lauren as classic sportswear – the epitome being his polo shirt. This typecast won't be easy to overcome'.

Third, local best practices (i.e., routines considered highly effective and efficient in one country, such as incentive systems for highly skilled workers or buyer–supplier relations) may not be considered as such abroad by a variety of stakeholders, and may even be deemed illegal.

Case example. *A typical example is the assessment of service quality in the hotel industry in locations such as Hong Kong versus the US. Hong Kong-based hotel groups such as the Peninsula have developed a high quality of services, partially because of Hong Kong's location characteristics as a regional business centre and travelling site. This quality of services is manifested by a high ratio of employees to rooms, among other factors.*

However, when these firms bought US hotels in the late 1980s, such practices were not appropriate, simply because labour in the US is more expensive than in Hong Kong. Therefore, maintaining the same high ratio of employees to rooms, though viewed as a best practice in Hong Kong luxury hotels, was inefficient in US luxury hotels. As a result, the Hong Kong hotel groups had to rely more on other methods to

assess and improve the quality of services in their US subsidiaries, such as a focus on more in-house training and the recruiting of more enthusiastic and younger staff.

The **fourth** kind of non-transferable FSA: even the firm's domestic recombination capability, which may have led to a dominant market share and superior expansion rate in the home country market, as the firm engaged in product diversification or innovation, and thereby increased its geographic market coverage domestically, may not be adept enough to confront the additional complexities of foreign markets.

Case example. *Office Depot, the leading office supply retailer in the US, entered the Japanese market in 1997. Trying to follow its American retailing style, Office Depot found it hard to attract Japanese customers. Office Depot opened stores in Japan following the American format: more than 20,000 square feet in size, wide aisles, signs in English, etc. In other words, the firm's initial focus was on transferring its domestic routines rather than its recombination capabilities.*

However, such an American format not only significantly increased the operating costs of the stores, but also failed to meet the habits of Japanese customers. On the one hand, both the personnel costs and the rents in Japan were significantly higher than in the US, resulting in excessive operating costs. On the other hand, Japanese customers did not value the American format: the large size gave them an unfavourable warehouse impression, as they were used to narrow aisles. In addition, the English signs confused them. On top of these problems, Office Depot needed to provide Japanese-style office products, different from American ones, which it had to purchase from local suppliers, who did not necessarily offer them the best possible prices.

More recently, the company has tried to use its recombination ability to adapt to the idiosyncrasies of the Japanese market. For example, it has started to operate both large and small stores, and has strengthened its delivery capabilities. The company has had only limited success: by 2005, Office Depot operated only 24 retail stores under the Office Depot brand, an insignificant number when compared with its 978 Office Depot superstores in the US.

One of the most interesting aspects of all four of these kinds of location-bound FSAs (immobile resources linked to location advantages, local marketing knowledge and reputational resources, local best practices in the form of routines and a domestic recombination ability) is that the corresponding FSA in each host country will need to be created or acquired from third parties operating in these foreign markets. Linking investments (such as Citigroup's affiliation with the Japanese Post Office, above) may be required to allow the matching of the MNE's internationally transferable FSAs with the relevant characteristics in host countries and regions. These linking investments can be viewed as investments in host country or host region responsiveness.

Case example. *The Taiwanese computer manufacturer Acer Inc. engaged in such linking investments when it entered Mexico in 1989. An experienced original equipment manufacturer for IBM and other top international PC companies, Acer did not have a distribution network in Mexico, nor did it benefit from strong brand recognition. Acer therefore contracted out its distribution and marketing activities to Computec de Mexico, a local Mexican distributor, and, in 1992, formed Acer Computec Latinoamerica (ACLA), a joint venture between Acer and Computec. Acer manufactured the PCs, but Computec (and later ACLA) was given high autonomy at the downstream end of the value chain in Mexico. They focused on small businesses and home PCs, and continued to invest in TV advertisements and other marketing media even during the 1994 peso collapse.*

This strategy paid off: by 1992, Acer's linking investments had made it the dominant brand in Mexico. ACLA became publicly listed on the Mexican Stock Exchange in 1996.

3 Location advantages

The MNE's economic success does not occur in a spatially homogeneous environment: location matters. Specifically, many firms are successful internationally because they take advantage of a favourable local environment. Location advantages represent the entire set of strengths characterizing a specific location, and useable by firms operating in that location. These strengths should always be assessed relative to

the useable strengths of other locations. Such strengths are really stocks of resources accessible to firms operating locally, and not access - ible, or less so, to firms lacking local operations. Location advantages are often instrumental to the type of FSAs that can be developed by locally operating firms relative to firms operating elsewhere.

For example, abundant natural resources may help the creation of successful firms in the natural resource industry.

Case example. *Consider the example of natural resources in Canada. Domestic firms have been able to leverage domestic natural endowments to compete successfully in the resource industry. Ranking fourth in the world in terms of natural resources reserves (subsoil assets and timber resources) behind only Saudi Arabia, Norway and Venezuela, Canada has significant reserves of wood, water, natural gas, oil, gold, coal, copper, iron ore, nickel, potash, uranium and zinc. In 2004, the Toronto Stock Exchange (TSX) and TSX Venture Exchange had over 1,100 mining companies listed, ranging from emerging explorers to world-class producers, and valued at over $118 billion US. As of 2004, major Canadian mining companies included: Alcan Aluminum Ltd., the second largest primary aluminum producer in the world; Inco Limited, the second largest producer of nickel; Barrick Gold Corporation, one of the largest gold mining companies in the world; Noranda, one of the world's largest producers of zinc; and PotashCorp, the world's largest producer of potash. (Inco Limited and Noranda have since been acquired by foreign competitors.)*

A superior educational system – another location advantage – will support firms that build upon sophisticated human resource skills.

Case example. *In Germany, the dual system for vocational education and training (VTE) has historically provided a stable source of highly skilled workers for German firms, and has helped these firms build a reputation for high product quality. VTE covers several hundred occupations and focuses on the majority of young Germans who will not pursue university-level studies. The responsibility for training is shared by both public training schools and private companies. Such VTE programs, specialized in printing, optics, automotive assembly, hydraulics, etc., have historically led to 'highly skilled, technologically competent graduates who are thoroughly*

familiar with the flexible manufacturing systems typical of today's industry'.40 VTE programs have thereby played an important role in helping a large number of German firms (Siemens, Hoechst, Volkswagen, etc.) retain their competitiveness in product performance and quality.

For similar reasons, the presence of a demanding and sophisticated local market for specific products will likely foster local innovation in the relevant industry.

Case example. *Consider the history of the Japanese home appliances industry. With limited natural resources and a large population, Japan has long been characterized by high energy costs, high living expenses and small dwellings, mainly apartments.*

Customer needs regarding home appliances have reflected these housing conditions. Air conditioners, washing machines, etc., need to be compact, convenient, quiet and energy-efficient, in order to fit into small apartments and use minimal energy. Such requirements have historically led Japanese firms to respond in innovative ways. For example, in the 1980s, '[W]hen market surveys revealed that workers living in apartments tend to do their laundry early in the morning or late at night – and that the sound irritated their neighbours – Japanese washing-machine makers came up with high-tech solutions. Their steel suppliers came up with noise-absorbent sheets – a layer of resin or polymer sandwiched between two thin steel plates. The new technique, also used to quiet noisy refrigerators, has led to a buying boom in two markets which had experienced virtually zero growth for several years'.

Location advantages do not confer an equal strength to all locally operating firms vis-à-vis firms operating elsewhere. Rather, the more effective and efficient use of location advantages by some firms – usually the combination of these location advantages with specific proprietary resources – may confer to them an additional FSA over other locally operating firms. This may explain why only a few firms from world-renowned domestic industries, such as the French perfume industry, have been able to grow internationally.

Case example. *In France, almost half of the perfume business has historically been concentrated in and around Grasse, a small town in Southern France with 'the largest concentration on earth of the most fragrant species of flowers'.*

Such unique natural resources and three centuries of experience in the perfume business have helped French firms develop world-class processing capabilities and craft skills in perfume development.

However, only a handful of French perfume firms have grown into large-scale MNEs. These firms, such as Moët Hennessy Louis Vuitton (LVMH), were best able to combine generally available, localized knowledge with modern product development processes. Traditionally, perfume firms relied on a 'nose' – a fragrance expert – to determine the right combination of fragrances to be included in a new perfume. However, most successful perfume developers – such as LVMH – now develop products 'backwards': they start with a concept, then design an ad campaign, and finally focus on the actual perfume to be produced.

Location advantages can vary widely in their geographical scope. In some cases, a location advantage accrues to all firms operating in a particular country, for example if the government has created a favourable tax regime for specific economic activities, or general business incentives for skill upgrading of human resources.

Case example. *Consider Ireland's location advantages. The impressive recent growth of Ireland has been attributed to a series of country-specific factors after 1987, including cuts in government spending, tax cuts, lower interest rates, European Union subsidies, the creation of a European single market in 1993, and government investments in education increasing the supply of skilled workers.*

All these factors drove the Irish GDP per person from 69 per cent of the EU average in 1987 to 136 per cent in 2003. New EU entrants from central and eastern Europe might want to follow the Irish formula for success, but '[T]his will not be easy',44 as it is almost impossible to replicate the trajectory over time of the entire portfolio of parameters that led to Ireland's success at the macro-level.

In some cases, location advantages accrue only to firms operating in part of a country. Economic clusters, for example, are usually located in only part of a country.

The physical locations of the firms that constitute the heart of the cluster determine the cluster boundaries.

Case example. *The US, the leading country for biotechnology innovation, has four main biotechnology clusters – small, distinct regions that have been called 'self-perpetuating centres of innovation and, hopefully, profit'. According to a recent study by the Milken Institute using 44 different metrics such as the amount of venture capital funding and the availability of local infrastructure, the San Diego cluster is ranked first, followed by the Greater Boston cluster (Route 128), the Tarheel troika of Raleigh, Durham and Chapel Hill, and finally San Jose, California. These four clusters received 'about 47% of all venture capital disbursed to US life sciences companies in 2003'. A successful biotech cluster requires four pillars: at least one large, nonprofit research university with a strong biomedical curriculum; venture capitalists who provide funding to biotech companies; local governmental support in creating a favourable environment for biotech firms; and a few publicly traded biotech companies.*

Firms tend to invest in established clusters to get close to the research environment there. One high-profile example is the shift of the command centre for global research at Novartis AG from Switzerland to the campus of the Massachusetts Institute of Technology, to be close to 'the centre of genetic research in the US', and 'to parlay the knowledge gleaned from gene hunting into the next generation of innovation treatments'. As noted by CEO Daniel Vasella, '[B]asing its research headquarters alongside the Boston area's booming biotechnology industry, academic institutions and their pools of scientific talent will play a critical role in discovering those drugs'.

Before this shift, Novartis had already established its US base in New Jersey, and had sited the Novartis Institute for Functional Genomics in La Jolla, California.

The new command centre is close to the Greater Boston cluster, the operation in New Jersey is close to the New York/New Jersey/Connecticut 'Pharm Country', and the institute in California is close to the San Diego cluster.

In other cases, location advantages reach across country borders. The creation of cross-border location advantages is one of the key purposes of most regional trading

and investment agreements, intended at least partly to confer a location advantage to insiders at the expense of outsiders.

Case example. *The North American Free Trade Agreement (NAFTA) has changed the distribution of trade. The sharp increase of trade among the NAFTA countries suggests trade diversion: 'the NAFTA may have deflected trade internally that would otherwise have taken place between individual North American countries and [the rest of the world] (the NAFTA dealt Mexico and Canada a price advantage over other countries and produced incentives for US customers not only to shift from domestic goods to imports, but to substitute imports from Mexico and Canada for imports from elsewhere)'.*

Another way to classify location advantages, as opposed to classifying by geographical scope (which may extend to a narrow cluster, a broader region within a country, a country or a region spanning more than a country), is to classify them by what motivates a firm to conduct economic activity in that location.

Because most of the book's examples to this point concerned ***home country*** location advantages (e.g., Canada's abundant natural resources conferring an advantage to domestic resource-based industries), the following discussion and classification of a firm's motivations will, for balance, focus on ***host country*** location advantages.

Why would an MNE want to engage in foreign direct investment in a host country? First of all, a key definition: foreign direct investment (FDI) is the allocation of resource bundles (combinations of physical, financial, human, knowledge and reputational resources) by an MNE in a host country, with the purpose of performing business activities over which the MNE retains strategic control in that country. The answer is that an MNE should engage in FDI only if the host country confers a location advantage relative to the home country.

In each case, the value proposition of the foreign activity must be more attractive than alternative value propositions at home. We can distinguish among four motivations to perform activities in a host country rather than at home.

The first motivation, ***natural resource seeking***, entails the search for physical, financial or human resources in host countries. These resources are in principle not proprietary, and their availability in host countries (which constitutes the location advantage of those countries) means that investment abroad leads to higher value creation than investment at home. A precondition to such investment is that the host country institutional environment actually allows foreign MNEs to access these resources.

Case example. *Faced with the continuing growth in the demand for energy, oil companies like Total SA are striving to replenish their reserves by developing or buying new oil fields around the world. Total SA, France's largest corporation and the world's fourth largest oil company, has been expanding its access to new reserves through various forms of FDI in the past several years.*

For example, in 2003, Total, the Royal Dutch/Shell Group and Saudi Aramco formed a joint venture for gas exploration in an area of 80,000 square miles in southeast Saudi Arabia.

In 2004, Total signed an agreement with the National Iranian Oil Co. (NIOC) and Malaysia's Petronas to develop the South Pars gas field in Iran. This gas field and Qatar's North field, taken together, represent the world's largest gas reservoir.

In 2005, Total acquired Deer Creek, a Canadian company, for 1.35 billion Canadian dollars. Deer Creek 'doesn't produce oil but holds an 84% interest in the Joslyn permit, an acreage in the Athabasca oil sands region of Alberta'.

The second motivation, ***market seeking***, reflects the search for customers in host countries. Firms are market seeking when they conclude that deploying productive activities and selling in the foreign market confers higher value to the firm than engaging in alternative investment projects at home. The host country location advantage is the presence of customers willing and able to purchase the firm's products. Note that market seeking is not the same as mere exporting: market seeking involves business activities in the host country, based on resource bundles transferred there over which the MNE retains strategic control.

Case example. *With a population of 1.3 billion and a wealthy middle class of 250 million, China has become an attractive market for many US food services brands, including Kentucky Fried Chicken (KFC), McDonald's, Dairy Queen and Pizza Hut.*

KFC was the first US food services company to invest in China, opening the first unit in Beijing in 1987. 'From the opening day the Beijing unit has served an average of 9,000 customers a day. Its astounding popularity has broken all the company's world sales records.' Individual restaurants had sales as high as $4 million per year, and the margins in China were more than twice the US average.

Another early success story has been McDonald's. As early as 1994, its huge 700-seat outlet in Beijing was reportedly serving '20,000 McDonald's customers a day, and as many as 50,000 on holidays'.

The third motivation for an MNE to invest abroad, ***strategic resource seeking***, is the desire to gain access to advanced resources in the sphere of upstream knowledge, downstream knowledge, administrative knowledge or reputational resources. These resources, which constitute the host country location advantages, are in principle not generally accessible, in contrast to the resources sought with natural resource seeking and market seeking. Therefore, this type of FDI typically involves taking over other companies, engaging in alliance activity or becoming an insider in foreign knowledge clusters. The underlying reasons to engage in strategic resource seeking typically include the goal to become an established industry player in a set of strategically important knowledge development centres or output markets.

Case example. *The Korean firm Samsung Electronics is now viewed as very close to its Japanese rival Sony as the world's leading consumer electronics firm58 after years of trying to catch up with foreign technologies in consumer electronics.*

From the early 1970s to the early 1990s, Samsung was able to reduce to less than one year its new product development gap behind the leading MNEs from the US and Japan. However, it realized it still needed additional access to advanced foreign technologies. To accomplish this, Samsung strengthened its in-house R&D and acquired/invested in high-tech companies such as LUX, a Japanese producer of high-end audio systems, and the US firm AST Research. Access to the latter firm's technical

know-how and patented technology allowed Samsung to reduce its technology sourcing and licensing dependence on IBM and other large firms.

Finally, ***efficiency seeking*** is a firm's desire to capitalize on environmental changes that make specific locations in the MNE's international network of operations more attractive than before for the consolidation or concentration of specific activities. Such environmental changes may include technological breakthroughs allowing greater scale economies; an increased industry focus on innovation, triggering higher required R&D investments; customer-induced, shorter product cycles; and the reduction of trade and investment barriers through regional agreements such as NAFTA and the EU. Here, the location advantages of the various relevant countries may change relative to each other, making one more attractive than another and therefore more likely to receive new FDI.

Case example. *Logitech, the world's leading mouse manufacturer, established its first manufacturing plant in Switzerland in 1981. It then established three foreign plants in the US, Ireland and Taiwan, to serve US and European PC manufacturers who wanted their suppliers to be nearby, and to benefit from lower costs and manufacturing design capabilities in Taiwan. After establishing its Irish plant, Logitech closed its Swiss plant.*

However, in the first half of the 1990s, Logitech suffered from inefficient manufacturing and an unclear customer focus. In order to remain competitive in an environment focused on cost cutting, it engaged in efficiency seeking FDI, and started production in 1994 at a plant in Suzhou, China. It simultaneously closed its Irish and US factories, and retained only a small production line for pilot runs in Taiwan.

Logitech reinforced its manufacturing base in China by launching a new factory in 2005. It currently manufactures half of its products at its Suzhou plant, with the other half outsourced to suppliers in Mexico, Hungary, Thailand and China.

The ***centralized exporter*** is essentially a market seeker: its internationally transferable FSAs are embodied in its final products, and the host country location advantage is simply the presence of customers willing and able to purchase the firm's

products. In the 'ideal' case, there is minimal need to develop location-bound FSAs in the host country, because of the products' desirability in host environments.

The ***international projector*** clones its home operations in the host country, replicating its internationally transferable FSAs. In the 'ideal' case, the host country operations directly access the local customers, without much need to develop new location-bound knowledge, again because of the desirability of the MNE's products.

The ***international coordinator's*** main transferable FSA is its ability to coordinate the location advantages accessed in multiple host countries. In some host countries, it may still be necessary to transfer substantial resource bundles to the host country operations, so as to gain access to the host's location advantages (e.g., production capacity to access abundant natural resources). In other countries there may be little need for this, namely if inputs can be accessed largely through third parties, such as the owners of natural resources or integrated logistics services providers. The actual coordination may occur largely in the home country or may be shared by a variety of locations.

The decentralized ***multi-centred MNE***, recognizing that each host country operation needs to build upon its own distinct location-bound FSAs, transfers only core routines (e.g., in the area of financial management and administrative best practices) to each host country operation.

4 Value creation through recombination

Value creation through recombination means that the firm is able to grow by innovating and diversifying. This means combining in novel ways existing resources, often in conjunction with newly accessed resources. In this process, managers find new profitable ways – in this case across borders – to use excess resources at a relatively low marginal cost and to meld these with newly accessed resources. Resource recombination is both a key driver and a key constraint of firm growth.

In any organization, resource recombination requires two things: first, entrepreneurial skills possessed by managers and other employees that can be deployed in the face of new productive opportunities; second, slack or unused productive

resources, beyond those needed for the efficient functioning of current operations. In the international context, there is usually a third requirement: the melding of existing resources with newly accessed resources in each host environment.

Resource recombination in general – and knowledge recombination in particular – is critical to creating value and satisfying customer demand, because all MNEs, even the largest firms included in the Fortune Global 500 list, have rivals who are trying to capture market share. Continuous innovation and effective exploitation of innovation is required to stay ahead of the competition.

Case example. *Carrefour, the world's second largest and most internationalized retailer, has been challenged by competitors both at home and abroad.*

In its French home market, Carrefour has lost market share to Aldi and Lidl, two German chains that have competed successfully based on their private label products and low prices. Carrefour has not been able to match these rivals' lower prices, as French regulations limit the extent to which retailers can reduce prices for branded products.

In Japan, Carrefour has had difficulties in purchasing land suited for new stores and in understanding Japanese consumers' needs. In 2005, it decided to leave Japan by selling its eight stores to Aeon Co., a local Japanese retailer. It also planned to sell its Mexican operations, which failed to gain a sufficient market share after ten years of operation.

Thus, Carrefour has been generally unsuccessful at applying its recombination capabilities to either maintain home market share or penetrate overseas markets.

When faced with competition, the MNE's most important strengths are usually not its physical, financial or human resources as stand-alone items.

Instead, the MNE's key strengths are its valuable, often proprietary knowledge, particularly its routines and recombination capabilities. Here, competitiveness results from the combination of stand-alone resources into bundles of location-bound and non-location-bound FSAs in technology, marketing and reputation, and from the capability to recombine these knowledge bundles with newly accessed resources to produce

goods and services that meet stakeholder needs internationally. Because the MNE is to a large extent a repository of knowledge bundles that can be deployed and recombined across borders, the firm's recombination capability can itself become the MNE's most important strength. Recombination, especially critical when satisfying stakeholder needs abroad, requires more than stand-alone knowledge bundles or existing routines. The MNE's recombination capability leads to processes and products that embody 'integrated bundles' of knowledge, meaning melded bundles of old and newly accessed knowledge. ***The recombination capability is the MNE's highest-order FSA.*** This capability means the firm can not only transfer abroad its existing set of FSAs, but also create new knowledge, integrate it with the existing knowledge base and exploit the resulting, new knowledge bundles across geographic space, in ways that satisfy stakeholder needs.

Effective recombination requires more than simply superior technology on the upstream side, market research skills on the downstream side, recognized brand names at the reputational side, the competent administration of current operations, etc. Instead, it requires entrepreneurial skills, because recombination cannot be easily planned beforehand, but requires the capability to adapt to new circumstances, especially when setting up a new business in a host country. It also requires unused or slack resources that can be deployed to develop new knowledge and perform the actual recombination. Finally, in host environments, it usually entails melding existing resources with newly accessed resources so as to overcome the 'distance' between existing operations and the host environment. One paradox needs to be noted here: strong routines, though a critical component of the MNE's FSAs, can sometimes be detrimental to recombination, and thus to the MNE's recombination capability. There is a fine line between routines being helpful to international business strategy, by contributing to economies of scope (sharing of knowledge across borders), and these same routines becoming detrimental to further resource recombination, thereby impeding national responsiveness or even the creation of new, nonlocation-bound FSAs.

5 Complementary resources of external actors

In many cases, MNEs need complementary resources of external actors (technology providers, licensees, local distributors, joint venture partners, etc.) to be successful abroad. The firm's domestically successful stand-alone FSAs, its routines and even its recombination capabilities may be insufficient or inappropriate to operate successfully in host countries and regions, because of the cultural, economic, institutional and spatial 'distance' from the home country or home region. In other words, some success ingredients may be missing, and these can then be provided by external actors, if at least two conditions are fulfilled. First, internal development of the required strengths is expected to bring a lower net value than relying upon external actors. Second, the need to rely on external actors can be satisfied in practice, and does not jeopardize the specific expansion project considered.

Case example. *The experience of Montedison in the US helps to illuminate the importance of complementary resources of external actors. Montedison, an Italian chemical company, tried to re-enter the US in the early 1980s, a few years after it failed in that same market with a wholly owned subsidiary. Montedison held about 17 per cent of the European capacity in polypropylene production, but it was weak in the US. Although it had experienced success in Europe and had even developed an advanced new processing technology for the production of polypropylene, venturing into the unfamiliar US market on its own appeared too risky, especially given its earlier failure. Montedison decided to team up with Hercules, the leading polypropylene producer in the US market. Hercules had FSAs in marketing and product applications, but was weak in process technology. Thus, the two companies felt they could achieve synergies through collaboration.*

In 1983, the two companies established a fifty-fifty equity joint venture, incorporating the successful marketing strategies from Hercules and the process technologies from Montedison. This joint venture grew into the world leader in polypropylene.

6 Bounded rationality

Bounded rationality reflects 'scarcity of mind', meaning that the managers responsible for making decisions and engaging in purposive action in the firm always face information problems.

Access to information sufficient in quality and quantity to guide decision making and managerial action is the first problem. However, even in the presence of all required information, managers have a second problem as well: a limited capability to process complex information bundles. Let us look at these information problems in more detail.

The ***first problem***: any information about the environment relevant to the MNE's functioning and performance, especially about the future state of the environment, is necessarily partial and incomplete, given the complexity and uncertainty characterizing the environment and its evolution.

Incomplete information about environmental complexity may impede successful international expansion, as documented by hundreds of international business case studies, and as observed on an almost daily basis in the media.

However, we should also recognize, paradoxically, that foreign market knowledge may in some cases alleviate bounded rationality constraints at home.

Case example. *In 1997, the US-based ice cream company Hòagen-Dazs launched the 'dulce de leche' flavour – a flavour similar to caramel – in Argentina, as the company realized that this flavour of ice cream accounted for about 30 per cent of the Argentinian market. This locally developed product proved to be a big hit in Argentina.*

At training seminars, 'North American executives who had tried dulce de leche at a brand conference in 1997 realized it might fit with the company's recent move to target Latinos in the US.' The dulce de leche flavour ice cream was introduced in the US in 1998, at first only in heavily Hispanic areas. The product did better than expected: sales in the US grew by about 27 per cent per month in 1998, and by 2001 it became the company's sixth-best-selling flavour in the US (out of 34 flavours). 'It's

remarkable and unusual to have a new flavour do so well', said Vivian P. Godfrey, Hɔagen-Dazs vice-president for North America.

The product's success in Argentina had given the company information relevant to its home market.

The ***second problem***: even if critical information is abundant and rather accurate, senior MNE management faces a problem of processing this information, especially in determining its relevance to the firm and its implications for strategy.

Case example. *Consider the use of newspaper inserts by Wal-Mart, the world's largest retailer, in Japan in 2004 and 2005: '[Wal-Mart] has made several changes in its use of newspapers' inserts, for instance, first eliminating them, then bringing them back when sales suffered. But it still hasn't made the inserts attractive enough . . . [During 2005, Wal-Mart planned to] make more use of the inserts to highlight products centered on traditional Japanese holidays and events such as cherry blossom viewing.'*

Newspaper inserts may be viewed as a minor, almost trivial managerial issue, but even for this seemingly trivial matter, it is interesting to observe that mighty Wal-Mart – with an experienced management team and a great deal of information about the Japanese consumer – could not easily and rapidly process this information to find the optimal insert template for Japan.

These two bounded rationality problems – incomplete information and difficulty with processing information – are compounded when operating in multiple geographic environments simultaneously, each with different levels of complexity and uncertainty, and therefore different implications for international business strategy.

7 Bounded reliability

Bounded reliability reflects the 'scarcity of effort to make good on open-ended promises': agents do not always carry through on their expressed intentions to try to achieve a particular outcome or performance level. This is why firms introduce safeguards or enforcement mechanisms to heighten detection of, and provide punishment for, reneging.

One source of bounded reliability is opportunism, which involves ex ante false promises and/or ex post reneging on promises, either by external contracting parties or by employees inside the firm. Opportunism is self-interestseeking behaviour with guile. Here, an intentional effort to cheat/shirk prevails, which benefits the cheating/shirking party.

A second source of bounded reliability is benevolent preference reversal, in which an actor's initial promise is made in good faith, but the actor's preferences then change over time, although not in a self-centred way. For senior managers in MNEs, the most relevant type of benevolent preference reversal is called 'good faith local prioritization'. In this case, overseas actors initially make a promise in good faith but, over time, divert their effort (and resources under their control) to the pursuit of local preferences, at the expense of organizational/global preferences. For example, at the level of foreign affiliates, the subsidiary manager may typically promise to try to carry out specific investment projects determined by corporate headquarters, and commit to specific performance requirements. However, the manager may change his preferences due to several causes, including: a substantial distance in time from any punishment for non-achievement; a substantial distance in space from the headquarter's monitoring apparatus; and the relative proximity and intrinsic satisfaction derived from focusing on autonomous, locally driven investment opportunities that give immediate local rewards to the subsidiary (such as an improvement of relationships with local stakeholders).

These bounded reliability problems cannot be simply reduced to bounded rationality issues, because they are not caused by a lack of information or an inability to process information. In the case of opportunism, the individual may possess all the relevant information, and in fact may process it perfectly.

The problem with opportunism lies with the individual's self-centred desires and effort. In the case of benevolent preference reversal, the problem is not with the individual's assessment of how the world is or will be. Again, the problem lies with the individual's desires and effort.

Bounded rationality is about the imperfect assessment of a present or future state of affairs, thereby leading to incorrect beliefs; bounded reliability is about imperfect effort towards pre-specified goal achievement, thereby leading to incomplete fulfilment of promises.

A single individual can engage in both benevolent preference reversal and opportunism. For example, suppose that an individual has engaged in good faith local prioritization: good faith promises were made to corporate headquarters, but efforts to make good on those promises have been replaced by the pursuit of local goals. As the time for performance appraisal approaches, this individual may wilfully and opportunistically engage in incomplete and inaccurate reporting of the performance gap.

It is also worth pointing out that individuals can perform as expected in the short term, yet also have underlying tendencies towards good faith local prioritization – tendencies that have not yet affected their behaviour (perhaps they are 'doing the right things for the wrong reasons'). Such individuals may produce long-term conflicts between the subsidiary and corporate headquarters (and perhaps the remainder of the MNE network).

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з навчальної дисципліни

«МІЖНАРОДНІ БІЗНЕС-СТРАТЕГІЇ»

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