CHAPTER 9

International Strategy

LEARNING OBJECTIVES

Studying this chapter should provide you with the knowledge to:

1. Discuss the globalization of business.
2. Explain why firms choose to expand internationally.
3. Describe different kinds of distance and how they affect successful international expansion and how this affects the choice of where firms should go when they expand.
4. Explain the three primary types of international strategy and be able to use the international strategy triangle to determine which international strategy is right for a specific firm.
5. Explain when a firm should use each of four major ways to enter a foreign market.

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Lincoln Electric Learns Some Difficult Lessons

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Lincoln Electric is one of the most celebrated companies in US history. Business schools across the entire world have made it the No. 1 case study about how companies manage their workforces. At first glance, it seems odd that Lincoln Electric should be so famous. Unlike Apple or Exxon, it doesn't have the highest market capitalization. Unlike Facebook or Google, it isn't in an industry that is fashionable or that innovates quickly. Lincoln makes welding machinery and the sticks of metal that welders melt to bond two objects together, known as welding consumables. Yet, in the last 20 years, Lincoln Electric captured the majority market share in the United States competing against such big-name firms as GE. It then went on to capture the largest share of the welding equipment and consumables market in the entire world. Lincoln currently manufactures in 20 countries and has distributors and sales offices in more than 160 countries worldwide.[1] Not bad for a Cleveland, Ohio-based manufacturing company.

Lincoln's success is often attributed to the way it pays its workers. Management believes that the way it compensates its workers maximizes their incentives to be productive. The three cornerstones of the company's compensation policy are:

1. *Piecework:*[2] Workers' pay is based on the number of pieces they produce rather than the number of hours they work.
2. *Year-end bonuses:* Big bonuses at the end of the year, based on personal evaluations and company performance, can often double workers' yearly earnings.
3. *Guaranteed employment:*[3] Since 1951, Lincoln Electric has promised not to lay off employees, no matter how difficult things become, a promise the company has kept to this day.[4]

Lincoln Electric's success story has not been free of trials. In fact, the first time Lincoln Electric decided to expand internationally, it nearly killed the company. From the mid-1940s until 1986, Lincoln Electric was primarily a US firm. Nearly all production

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occurred in Cleveland. The company had opened plants in Canada, Australia, and France shortly after World War II, but these were mostly autonomous units. However, from 1986 to 1992, the company—fearing a slowdown in the US market and seeing foreign competitors grabbing market share in the United States—embarked on a period of rapid international expansion.

During those 6 years, Lincoln Electric went from little international presence to buying or building three overseas plants per year. Lincoln acquired and built a plant in Venezuela, acquired existing plants in Mexico, Brazil, Scotland, Norway, the United Kingdom, the Netherlands, Spain, and Germany, and built a plant in Brazil and three in Japan, among others—a total of 17 plants in 15 countries. None of the top management team, however, had any international experience. The company bought plants intending to rely on the existing plant managers' local knowledge. Lincoln also decided to use the local brands of the plants it bought, because local managers had assured Lincoln's executives that Europeans, in particular, would not buy US-branded products.

Lincoln's leaders had hoped to install the renowned Lincoln Electric incentive system in each of its new international plants. However, none of the foreign units implemented the system. Lincoln's managers were not aware that many local laws forbid parts of the Lincoln system. In some locations, local management and workers didn't see its value. None of the foreign units except Canada and Australia, the older ones, turned out to be profitable.

Top management in Cleveland knew that the foreign units were struggling but, not having experience running a multinational company, they used a hands-off policy and weren't aware of exactly why things weren't working. When Lincoln's CEO retired in 1992, the new CEO was handed the reins to a company in which losses in the foreign units had become so huge that Lincoln Electric had to borrow money for the first time in its history. The company then nearly defaulted on its bank loans—twice—surviving only by begging the banks for more generous terms. Twice, Lincoln had to borrow money to pay the year-end bonuses that were so critical to its competitive advantage.

To fix the foreign operations, the new CEO moved to the United Kingdom and spent more than a year personally overseeing the plants in Europe. He broke local unwritten cultural rules about taking market share from other local companies by aggressively selling Lincoln Electric US-branded products at trade shows and in every other venue he could introduce them. He also broke a long-standing Lincoln Electric policy of promoting managers from within the company. Instead, he worked to lure key managers from other US firms that had significant international experience. He led the company to close plants in Germany and Japan—despite having just bought or built them—and rationalized production in the remaining plants, so that each was manufacturing a different product, rather than competing with other Lincoln plants.

By the middle of 1994, Lincoln had turned things around. Its foreign operations had become profitable as outlined in Table 9.1.[5] Since then, the lessons the company learned have been applied over and over, with great success, leading to Lincoln's current position as market leader in many countries around the world.

TABLE 9.1 Lincoln Electric Income (in US $millions)

	1987	1988	1989	1990	1991	1992	1993	1994
United States	49.9	55.9	53.0	28.2	30.8	24.9	42.6	71.7
Europe	1.5	3.1	4.4	2.1	−14.4	−52.8	−68.9	3.9
Other regions	1.3	2.0	−0.6	−6.8	−2.9	−7.2	−22.9	5.5
Total	52.7	61.0	56.8	23.5	13.5	−35.1	−49.2	81.1

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This chapter will help you to answer three critical questions about strategy, specifically concerning international expansion: Why, Where, and How. Carefully researched and thoughtful responses to those three questions can make the difference between a successful expansion effort and failure, or near failure, like Lincoln experienced.

The Globalization of Business

During the last 50 years, the scope of business has changed for most organizations. Companies used to compete primarily within their own country. Technological advancements in communications and transportation, along with falling trade barriers, have changed that for most firms. The average tariff, the tax on goods imported into a country, dropped from more

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than 40 percent to an average of 4 percent in developed nations. At the same time, countries across the globe repealed regulations that kept foreign firms from buying local companies and building plants and stores in their markets. As a consequence, the volume of international trade and companies selling across national borders, has increased more than 28-fold since 1970.

International trade in merchandise alone topped $12 trillion last year.[6] During the same period **foreign direct investment** (FDI), companies building factories and stores in foreign countries, increased more than 500 percent (see Figure 9.1).[7] Although there is no consensus on why FDI flows to some countries and not others, common factors include low labor and tax costs, low trade barriers, and favorable exchange rates.[8]

foreign direct investment Direct investment in production or business in one country by a business from another country.

This trend toward increased international trade has allowed organizations to place parts of their value chains in different countries, depending on where each part can generate the most value. Manufacturing, as well as service industries, has become global. Trade in commercial services, such as licensing and franchise fees, as well as other types of services such as financial, information, computing, insurance, and consulting services has increased 272 percent just in the last decade, totaling more than $4.8 trillion in 2015.[9]

What this means for strategy is that both production and the market for many products and services isn't national anymore—it's regional (a part of the world) or global.[10] For most industries, the competition isn't just local or national anymore, either—it's also global, and key competitors may be located in another country. Indeed, the World Trade Organization says that half of all the productive wealth in the world is generated by **multinational firms** that compete with an international strategy.

multinational firms Firms that sell or produce in multiple countries.

Even for small companies, international strategy is the key to success. Of the more than 408,000 US firms that competed across borders in 2014, 98 percent were small to medium-sized firms.[11] Companies that do international strategy right tend to dominate both at home and throughout the world. Most organizations that hope to be leaders in their industry realize that they have to compete on a global scale.[12] Indeed, for many companies, even basic survival is predicated on a clear understanding of international strategy.

Of course, competing on a global stage isn't just about protecting oneself from foreign competition. It also opens up tremendous new opportunities[13] although these new opportunities come with an exponential increase in complexity. Just ask the top management team at Lincoln Electric. Some of the differences between countries that increase complexity and affect the success of international strategies include variations in:

- Customer tastes, needs and income levels
- Government regulations
- Legal systems
- Public tolerance for foreign firms
- Reliability, and even existence, of basic infrastructure, such as roads and electricity
- Strength of supporting industries, including distribution channels to customers

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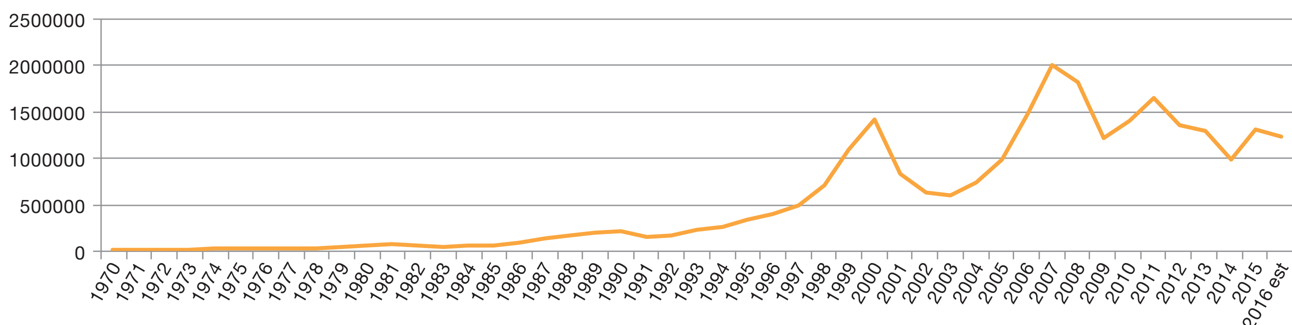

FIGURE 9.1 **Global Foreign Direct Investments, 1970–2016 (in 2016 US. dollars)**

Source: UNCTAD, Inward and outward foreign direct investment flows, annual, 1970–2016 and OECD FDI in Figures, February 2017.

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