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Developing new avenues for growth: Challenges presented by five trends in the global environment

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ABSTRACT

This paper documents five major trends in the global environment, and examines the impact of each on the corporate strategies of multinational firms striving for higher rates of growth in corporate earnings. The five trends documented are: 1. shifts in economic activity and growth between and within regions of the world; 2. increasing demand for goods and services among the very poor in emerging markets; 3. a faster pace and wider locus of technological innovation; 4. Increasingly global labor markets; and 5. increasingly ubiquitous and inexpensive access to information and knowledge.

Each of these trends presents multinational firms with a potentially new avenue for growth, or an avenue down which they should consider moving further and/or faster. These potentially new avenues for growth are encouraging managers of multinational firms to challenge the current corporate strategies of their firms, and examine the need to reorient or renew them. The paper discusses the strategic challenges associated with these new avenues for growth, and the need for more research on the concept of country risk, on the concepts of the transnational strategy and organizational structure, and on the challenges of very limited sustainable capacity to consume among the very poor.

1. Introduction

According to recent surveys, senior managers of business firms are increasingly setting high priority goals to increase corporate growth (Global CEO Study, 2004). Primary among the reasons for increased managerial focus on corporate growth are perception of increasing growth opportunities, and/or increasing threats to growth stemming from developments in the global economy. In general, the developed countries of the world are mature and growing slowly. Also in general, low-cost competition from firms in emerging countries has been capturing increasing shares of many markets in both economically-developed and economically-developing countries.

The rate of growth in corporate profits (RGCP) is highly correlated with the total shareholder value (TSV). According to one empirical study, variation in RGCP explains two thirds to three/fourths of the variation in TSV over time (Zook and Allen, 2000). While correlation studies cannot prove causality, most managers would agree based on their experience that a decline in or increase in a firm's RGCP will result in a decline or an increase in its market capitalization at some point in the future, and hence it's TSV. Few would hazard precise quantitative forecasts of the magnitude of changes in TSV in response to changes in RGCP, or its precise timing, but most would agree that “larger percentage” changes in the RGCP are likely to result in “larger” changes in TSV, and many would anticipate that the impact on TSV would happen “sooner” rather than “later.”.

Given the increased emphasis on corporate growth, senior managers of business firms are increasingly challenging their current corporate strategies, examining the need to reorient, and in some cases, renew them. The author defines corporate strategy

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as consisting of three major elements: 1) the current product/market/geographical scope and shape of the firm, 2) the competitive models currently being implemented in each business in which the firm has invested, and 3) the dynamic capabilities of the firm to create and implement new more competitive business models for existing businesses, for new businesses, and for new geographic areas. Many managers believe that the current corporate strategies of their firms do not take full advantage of the opportunities for growth, and/or have not adequately decreased the threat of decline in RGCP due to recent developments and trends in the global environment.

1.1. Research on international strategies for growth

Research on international strategy has historically focused on how expanding internationally may make it possible for firms to increase their profitability in ways not available to firms that continue to operate only within their domestic borders. Firms that expand internationally are able to:

1) leverage products and other valuable resources across national borders,
2) realize location economies by dispersing value creating activities to locations where they can be performed more economically, and
3) realize greater economies of scale and experience curve effects by coordinating value creating activities across national borders, or by concentrating them in only one or a few of the country locations in which they operate.

Firms that expand internationally are able to increase their profits in these ways, however, only within the constraints of competitive and political needs to customize their product offerings, their marketing strategies, and their investment profiles to differing country conditions (Hill, 2006).

Recent research in international strategy has emphasized three major strategy formulation tasks:

1) determining where to expand internationally,
2) determining strategic modes of entry into the markets of individual countries, and
3) determining the type of international strategy and structure best suited to varying levels of competitive pressures for cost reductions and for responsiveness to differing country conditions.

1.1.1. Determining where to expand internationally

Systematic approaches to determining where to expand internationally developed and described in the literature typically start with a rating of countries on a variety of dimensions deemed important to each company's market entry objectives such as market size, and market growth. In addition to attractive country dimensions, potentially negative or “risky” dimensions of each country such as political risk, cultural distance, geographic distance, economic environment stability, foreign exchange volatility, and regulatory environment are then ranked (Johansson, 2000). Most approaches then proceed to develop a measure of “expected return” and a measure of “country risk” making it possible to view each country being considered in terms of its comparative risk and potential return. Some authors suggest weighting the various potential risk-return factors on which each country studied was rated to arrive ultimately at a single number reflecting each country's weighted ranking compared to the others studied (Saaty, 1980).

1.1.2. Determining strategic mode of entry into a foreign market

A company deciding to enter a foreign market can choose from among several different modes of entry. These different modes of entry can be classified into two broad categories: wholly owned modes of entry, including acquisitions, and “greenfield” investments, and cooperative modes of entry, including equity joint ventures, nonequity alliances, and a variety of contracts. Each mode of entry involves different levels of control over foreign operations, and potential returns from foreign operations. Each also involves different levels of investment, risk and attractiveness to foreign governments.

Research on choice of entry modes has heavily emphasized ownership and internalization advantages of wholly owned modes of entry. Retention of ownership of the tangible and/or intangible assets developed in the firm's home or third-country markets when entering a foreign market makes a high degree of control over those assets possible. Cooperative modes of entry inevitably involve some sharing of control of the assets the firm is attempting to leverage into growth and profit in the foreign market. A firm's loss of full control of the assets being leveraged into foreign markets cannot, according to transaction cost theory, be appropriately compensated for because of imperfections in intermediate-product markets such as knowledge and expertise embedded in patents and in marketing and production activities. Property rights on the knowledge embedded in R&D-intensive products, and in well developed marketing and production processes cannot easily be defined and enforced through contracts between the internationally expanding company and third parties. Hence, according to transaction cost theory, the best way for a firm to fully appropriate the value of such intangible assets is to internalize within the boundaries of the firm the process of leveraging them into growth and profitability in foreign markets (Agarwal and Ramaswami, 1992).

Full ownership and internalization of entry into a foreign market involves the greatest amount of investment and associated investment risk among the alternative entry modes. In addition, the governments of a significant number of countries forbid or severely restrict foreign firm investment without significant participation of the government or local business. Thus, while it may be a firm's preferred mode of entry, it may not be available as an option in some countries otherwise attractive for foreign entry.