

Chapter 2

The Integration/Responsiveness- and the AAA-Frameworks

MNCs are exposed to two sets of strategic forces to which they must respond but which are at least partly conflicting, namely forces for global integration and forces for local responsiveness. In the Integration/Responsiveness-framework (I/R-framework), a fourfold typology of MNCs has been proposed based on the differing strengths of the two forces. More recently, the AAA-framework, comprising adaptation, aggregation and arbitrage, has been proposed as an improved concept to describe MNC strategies. Both frameworks are described in detail in this Chapter.

Forces for Global Integration and Forces for Local Responsiveness

One of the most influential typologies of MNCs stems from the studies by Doz, Prahalad, Bartlett and Ghoshal in the 1970s and 1980s. The tension between external forces towards adaptation to the local environment in the different host countries (“local responsiveness”) and the forces towards a standardised approach, leading to global efficiency by a worldwide integrated behaviour (“global integration”), are the basis of this typology (Doz 1980; Prahalad/Doz 1987; Bartlett/Beamish 2014):

- *Global integration* means interconnecting the international activities of the MNC across all countries, identifying the strengths of the large company, and trying to achieve synergy effects. Thus, the different countries in which an MNC operates can be linked to each other. This could be, e.g., because economies of scale are particularly high in a specific industry, leading to the necessity of internationally standardised products. Alternatively, it could result from comparative cost advantages of a country that offer an incentive to specialise the activities of certain foreign subsidiaries, leading to interdependence between the worldwide activities. Necessity for worldwide learning, in order to exploit knowledge company-wide that has been created in a particular country or the situation in which relevant actors around the MNC (e.g. customers, competitors, and suppliers) are the same in different foreign markets, enhances the requirement and the potential to coordinate closely the different international activities. These interdependencies between countries (which vary by industry) are called “forces for global integration”.

*Global
Integration*

Local Responsiveness

- At the same time, an MNC operates in heterogeneous conditions in many different host countries. The local unit in each country deals with different local customers and host governments, different market and distribution structures, and different competitors. Multinational flexibility, i.e., the ability of a company to exploit the opportunities that arise from this heterogeneity, is necessary. This contingency condition for MNCs is referred to as the “forces for local responsiveness”. This pressure to adapt varies by industry.

Forces for Global Integration

In a global industry, a firm’s competitive position in one country is strongly affected by its position in other countries. The forces for global integration, also called *industry globalisation drivers*, can be divided into four categories (Yip 1989; Bartlett/Beamish 2014, pp. 102-105):

- market drivers
- cost drivers
- governmental drivers
- competitive drivers.

Market Drivers

First of all, *homogenous customer needs* in the different markets may create opportunities to sell standardised products. With common customer needs, marketing becomes transferable across countries. The *culture convergence thesis* by Levitt (1983) suggests that different cultures become more similar, and lifestyles and tastes converge worldwide. However, this thesis is not without opposition. Meanwhile, more and more often, particularly in B2B markets, companies also meet *global customers*, i.e., companies (sometimes even private consumers) that are their customers in different country markets, e.g. different subsidiaries of the same MNC. Similarly, *global channels* such as large international retailers like *Walmart* and *Tesco*, or global e-commerce channels like *Amazon*, emerge in certain industries. All these aspects enhance the need for globalisation in an industry.

Cost Drivers

From a cost perspective, different industries have different incentives to standardise. For example, *economies of scale* in a particular production plant can be increased with standardised products that are exported to different country markets. Economies of scale and scope as well as *experience curves* differ from industry to industry, though. This can be caused by different production technologies. The greater the potential economies of scale and the steeper the experience curve, the more likely an industry is to turn global. Furthermore, industries where *product development* is *expensive* and at the same time *product lifecycles* are *short* or technology is fast-changing usually

try to use global scale effects. While *global sourcing efficiencies* might be given in an industry, leading to concentration of supply and manufacturing, inter-country differences in labour costs and factor endowments might make concentration of production useful. Over the last few decades, logistics costs have generally been decreasing, making globalisation easier to achieve. However, how energy prices, climate change, and also technological innovations will influence logistics and consequently location strategies remain to be seen.

Many governmental drivers also have an influence on the need for globalisation in an industry. For example, uniform *technical standards* are necessary for product standardisation, *liberal trading regulations* with low tariff and non-tariff barriers to trade, and common market regulations are drivers for globalisation, making cross-border trade easier. Inversely, high trade barriers obviously reduce the forces towards globalisation, protecting local particularities.

As the most important competitive driver, *global competitors* enhance the need for globalisation. Only companies that manage their worldwide operations as interdependent units can implement a coordinated strategy and use a competitive strategy sometimes called “*global chess*” (Bartlett/Beamish 2014, p. 105), i.e., responding to threats in one market by reactions in other markets. Additionally, large multinational companies offering the same products and brands around the world also promote the convergence of tastes and customer demands. International networks, e.g., in production, that also enhance the interdependence of countries and markets emerge in the presence of many MNCs.

The overall level of globalisation of an industry can be measured by the ratio of cross-border trade to total worldwide production, the ratio of cross-border investment to total capital investment, the percentage of sales of worldwide standardised products, or the proportion of industry revenue generated by large MNCs.

Forces for Local Responsiveness

Alternatively, depending on the industry, companies are facing another set of influence factors that make local responsiveness necessary (see, e.g., Hollensen 2014, pp. 25-26).

The predominant reason for the need for local responsiveness is a strong difference in *customer demand*. This might be caused by profound cultural differences in tastes, different environmental conditions (climate, topography, etc.), or different income levels and income distribution, among many other factors. A different *structure of the distributive sector* might make adapta-

Governmental Drivers

Competitive Drivers

Differences in Demand

Differences in Country Conditions

tions to the distribution strategy necessary. A different *competitive situation* in different markets might also force a company to change its strategy, adapting it to the local market conditions. Similarly, *protectionism* by governments often leads to the need to produce locally and/or adapt products to specific markets. While the need for adaptation has occurred at the country level in the past, it now increasingly occurs at the level of regional integration areas such as the EU (see Chapter 7).

Local responsiveness can also become necessary or beneficial due to either different labour conditions, e.g., labour cost or skill level, that require adaptation of production processes to optimise efficiency, or the availability or non-availability of suppliers. A low number of potential suppliers might make a higher level of vertical integration in the production steps more or less efficient due to a lack of alternatives. Different work attitudes that may be rooted in different cultures (see Chapter 9) might make different leadership styles more or less effective in different countries.

The I/R-Framework as a Matrix

While both forces are interconnected, they are not seen as opposing extremes of a continuum of possible situations but rather as two separate dimensions.

Figure 2.1

The Integration/Responsiveness-Framework



Source: Adapted from Bartlett/Ghoshal 1989, p. 438.

While the full independence of both dimensions is sometimes doubted in the literature (see, e.g., Engelhard/Dähn 2002; Morschett 2007), the advantage of

the assumption is that one can try to distinguish between both sets of forces more clearly and the potential external situations that an MNC faces can be illustrated in a matrix. The typology of Bartlett/Ghoshal (1989) that builds on this two-dimensional framework is the most commonly used. In this model, MNCs are grouped according to their strategic orientation. The framework has been very influential in IB literature, in particular that regarding the transnational MNC. The four strategy types are subsequently described in more detail (see, among many other authors, Harzing 2000, and Bartlett/Beamish 2014, for a more comprehensive description).

International Organisations

MNCs with an “international” strategic orientation tend to think of their foreign activities as *remote outposts* whose main role is to support the parent company by contributing incremental sales. This strategy type can be linked to the international life cycle model by Vernon (1966), since the focus is on exploiting knowledge, new products, or processes of the parent company by transferring them to foreign markets. Foreign countries are rather seen as a source of short-term and incremental profits. Accordingly, the company does not adapt to the specific host country, and the foreign activities are also not systematically integrated in the MNC. This strategy type is *ethnocentric* since the foreign activities only secure the company in its home territory. A strong dependence of the foreign subsidiary on the resources of the home country is a consequence.

Global Organisations

Companies with a “global” strategic orientation focus their organisation on achieving economies of scale. They are usually to be found in industries where forces for global integration are strong and forces for local responsiveness rather low. *Price competition* in global industries is high, thus, the dominant strategic need is *global efficiency*. The most relevant resources are concentrated in the headquarters and decisions are *highly centralised*. The MNCs attempt to rationalise their production by producing *standardised products* in concentrated production plants that fulfil a worldwide demand volume. Usually, these production plants are located in the home country and the most relevant task of the foreign subsidiary is to act as a “*pipeline*” for the parent company, selling products in its local market. R&D and innovation are also concentrated in the home country. Information flows and product flows are *unidirectional*; the MNC follows a *centralised hub model* (see Chapter 1).

*Focus on
Economies
of Scale*

*Focus on
National
Differences*

Multinational Organisations

The multinational organisation, being in the lower right corner of the matrix in Figure 2.1, focuses primarily on *national differences* to achieve its strategic objectives. Many of its characteristics are the *reverse of the global organisation*. Products, processes, strategies, even management systems, might be *flexibly modified* to each country to *adapt to local needs* and sometimes to *local governmental regulations*. This adaptation to the local markets is facilitated by *local production* and *local R&D*. While the main task of subsidiaries is to identify and fulfil local needs, the foreign subsidiary is also provided with the necessary local resources to respond to the local needs. The subsidiaries are independent of the headquarters and are also not linked to peer subsidiaries in other countries. The organisation takes the form of a *decentralised federation*.

Transnational Organisations

While global organisations and multinational organisations emphasise either global efficiency and integration or multinational flexibility and local responsiveness, the transnational organisation tries to respond *simultaneously to both strategic needs*. Thus, particularly in industries where both forces are equally strong, transnational organisations reach for the benefits of combining characteristics of both global and multinational companies.

*Responsive AND
Integrated*

Accordingly, a transnational strategy refers to becoming strongly responsive to local needs while still achieving the benefits of global integration. As described in Chapter 1, the underlying model is the *integrated network*, where key activities and resources are neither centralised in the headquarters nor fully decentralised to each country. Instead, resources and activities are *geographically dispersed but specialised*, leading to *scale economies and flexibility*. A certain level of product adaptation to local needs is combined with *cross-border production processes* that still concentrate production, such as that for specific common components, in single locations. This leads to *reciprocal and horizontal product flows*. Large flows of products, people, capital, and knowledge between subsidiaries are characteristic of transnational organisations. Innovation occurs in different locations and is subsequently diffused worldwide, while foreign subsidiaries can serve in strategic roles, such as for producing specific products, or as *centres of excellence*.

*Ideal Type in
Specific
Situations*

While this strategy type is often seen as an *ideal type* in literature, it is highly complex, costly and difficult to implement, and very ambitious. Empirical studies often show that few MNCs actually represent this type, and while many recent textbooks and management consultants invariably promote the transnational organisation as the “best” MNC type, this should be carefully analysed. The original authors recommend the complex transnational organ-

isation only for MNCs that are confronted with a complex environment with equally high forces for integration and responsiveness. “Organizational complexity is costly and difficult to manage, and simplicity, wherever possible, is a virtue” (Ghoshal/Nohria 1993, p. 24). However, more and more industries are currently developing into this situation of complexity.

Comparison of the Four MNC Types

Table 2.1 summarises and compares a number of different characteristics for the four MNC types.

Selected Characteristics of the Four MNC Types

Table 2.1

	International	Global	Multinational	Transnational
Role of Subsidiary	sale of HQ products	implementation of HQ strategies	identification and exploitation of local opportunities	differentiated contribution to the worldwide competitive advantages of the MNC
Network Model	centralised hub	centralised hub	decentralised federation	integrated network
Vertical Product Flows	high, sequential	high, sequential	low	bidirectional
Inter-subsidiary Product Flows	low	low	low	high
Centralisation of Decisions	high	high	low	medium (decentralised centralisation)
Management Transfers, Visits, Joint Working Teams	low	high	low	high
Centres of Excellence	low	low	low	high
Product Modification	low	low	high	high
Local Production	low	low	high	medium
Dependency	strong dependence	strong dependence	in-dependence	inter-dependence

Source: Summarised and adapted from Macharzina 1993, p. 83, p. 102; Harzing 2000, p. 113; Bartlett/Beamish 2014, pp. 198-201.

Perlmutter's EPRG Concept

A similar typology of MNCs also prominent in International Business research has been proposed by Perlmutter (Perlmutter 1969; Wind/Douglas/Perlmutter 1973). Perlmutter developed the EPRG scheme, distinguishing between ethnocentric, polycentric, regiocentric, and geocentric attitudes. In this scheme, he recognises that managers of MNCs have different attitudes or a different “state of mind”, i.e., assumptions upon which key decisions in the MNC are made.

- In the *ethnocentric* state of mind, the home country is implicitly considered to be superior. Key positions in foreign subsidiaries are staffed with expatriates from the home country and decisions are taken in the headquarters. Foreign activities are seen as less relevant than home-country activities and exports are the main entry mode. The subsidiary is highly dependent on headquarters.
- *Polycentric* firms start with the assumption that host-country cultures are strongly different and adaptation is necessary. They acknowledge that local employees are more effective for this task and that decentralised decisions help to exploit local differences effectively.
- While the polycentric attitude strives for optimal local solutions, this might be sub-optimal for the whole organisation. As a further development, the *geocentric* attitude emphasises interdependencies and aims for a collaborative approach between headquarters and subsidiaries as well as among subsidiaries. An optimal allocation of resources and synergy effects are aimed for.
- The *regiocentric* approach is a mix between the polycentric and the geocentric approaches. Strategies, products, processes, etc., are closely coordinated within different regions (e.g. Europe, North America), while the regions operate relatively independently of each other.

EPRG and the I/R-Framework

While the similarity to the I/R-framework is obvious and both approaches can be linked via the three network models, with the centralised hub model being ethnocentric, a decentralised federation model being polycentric, and the integrated network being the organisational response in the case of a geocentric state of mind, there are two major differences. While the I/R-framework offers contingency conditions under which external industry forces influence an MNC strategy in a particular way, Perlmutter offers a more qualitative explanation based on the management style or on the *state of mind*. Secondly, Perlmutter's EPRG scheme is not systematically based on describing characteristics. The "regiocentric" approach, however, which is very common in modern MNCs and also very prominent in recent IB literature (see, e.g., Rugman/Verbeke 2004), was identified by Perlmutter but is not considered in the I/R-framework.

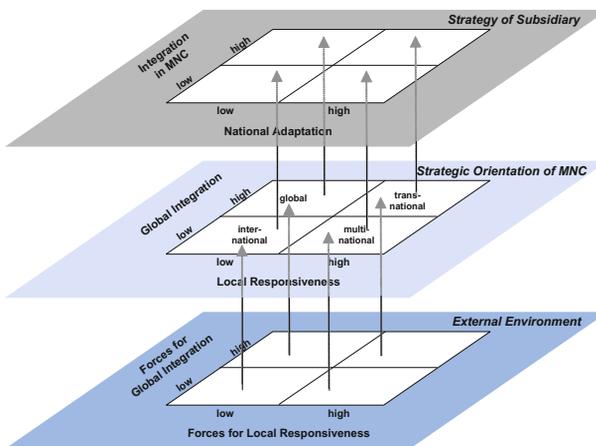
Different Levels of Integration and Responsiveness

The I/R-framework is a *contingency framework* that derives MNC strategies from a given external context. The main assumption is that an MNC in a specific industry exposed to a particular configuration of forces for global integration and local responsiveness needs to develop a strategy in accord-

ance with the external context. However, while the original framework clearly emphasises that MNCs have complex sets of options and that not only industry characteristics determine company strategies, management literature has often applied the framework in a deterministic manner, implying that MNCs in a particular cell of the matrix *have* to use a specific strategy. Consequences were immediately drawn at the company level as a result of a categorisation of industries: “the primary use of the ‘I-R grid’ was to map industries, and therefore to indicate what strategy a firm should pursue” (Westney/Zaheer 2001, pp. 356-357).

Three Levels of the I/R-Framework

Figure 2.2



Source: Morschett 2007, p. 396.

Figure 2.2 shows an extended model for a more detailed analysis of integration and responsiveness, consisting of three levels:

- the *external environment*, where the forces for global integration and the forces for local responsiveness are at different levels, depending on the industry
- the *MNC's strategic orientation*, where some MNCs prefer to use a global strategy and others a more multinational approach, i.e., to display different levels of global integration and local responsiveness
- the *strategy of the subsidiary*, which can differ and be more or less integrated in the MNC, and which can be more or less adaptable in its be-

haviour to the local market, as becomes evident in the role typologies (see Chapter 3).

Strategic Orientation of the MNC

Many authors use the I/R-framework to describe different MNC *strategies* (“internationalisation strategies”) or *organisational types* (“MNC organisations”). Kutschker (1999, p. 110) labels the four I/R-strategies “*archetypes of international companies*”. Here, *instead of forces*, the *degree* of integration and the *degree* of localisation of the MNC are used. In this case, as described above, the four strategy alternatives are seen as typical *bundles of strategy elements*, consisting of specific coordination mechanisms, product flows, product modifications, etc.

*Externally
Determined
Strategy or Strategic
Choice*

In a contingency-oriented perspective, these strategies are often derived from the context, according to most authors. The model is based on the assumption that a match between external forces and company strategy is more efficient than a mismatch (De la Torre/Esperanca/Martínez 2003, pp. 67-69). As Yip (1989) argued, the *globalisation of the strategy* has to be aligned with the *globalisation potential of the industry*. But still, companies have a certain level of freedom in the development of a strategy, which is called *strategic choice* (Child 1972). MNCs may choose alternative strategies based on their internal resources, strategic priorities, and other considerations. Clearly, external characteristics are only one part of the factors influencing company strategy and internal forces also play an important role in the determination of strategy.

Strategy of a Specific Subsidiary

Similarly, it has to be recognised that an MNC strategy does not necessarily lead to uniformity at the level of subsidiaries. The fact that the MNC follows a global strategy or a multinational strategy alone does not fully determine the subsidiary level (Jarillo/Martinez 1990; Birkinshaw/Morrison 1995). The level of local responsiveness and the level of integration may widely differ within a particular MNC. One reason is that the forces for global integration and the forces for local responsiveness not only differ by industry but may also vary from country to country. For example, trade barriers might be low, technological standardisation high, and consumer demand similar in most countries, but the reverse might be true in others.

*Different Subsidiary
Strategies in
the Same MNC*

*Contingency
but Not
Determination*

Differentiation between subsidiaries, while most prominent in the transnational organisation, is to some degree used in all types of MNCs. Thus, in the perspective of the “differentiated network” (Nohria/Ghoshal 1997), the level of the subsidiary must be planned separately. While it is evident that multina-

tional-oriented MNCs have a relatively high percentage of independent subsidiaries with high autonomy to exploit local market opportunities (Harzing 2000, p. 107), and most subsidiaries of an MNC with a global strategy will be dependent on the headquarters and merely implement the global strategy, heterogeneity between subsidiaries is common.

Consequently, even in globally oriented MNCs, some subsidiaries will have higher degrees of freedom and might even take over strategic roles. Particularly in transnational organisations, it is obvious that the role of each subsidiary is planned separately (see Chapter 3) and it may, in fact, for some subsidiaries mean a very low level of adaptation and a strong integration in the MNC network, usually characteristics of a global strategy.

AAA-Framework

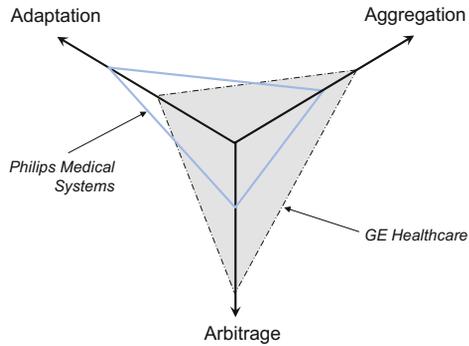
More recently, Ghemawat (2007) from Harvard Business School proposed a three-dimensional framework to describe international strategy. It clearly builds on the integration-responsiveness tension but extends it. As Ghemawat (2007, p. 60) argues: “assuming that the principal tension in global strategy is between scale economies and local responsiveness encourages companies to ignore another functional response to the challenge of cross-border integration: arbitrage. Some companies are finding large opportunities for value creation in exploiting, rather than simply adjusting to or overcoming, the differences they encounter at the borders of their various markets.” The so called AAA-triangle encompasses three dimensions of the international strategy:

- *Adaptation* intends to increase sales by optimally exploiting the local demand.
- *Aggregation* intends to reach economies of scale by creating global operations.
- *Arbitrage* intends to exploit differences between countries, often by establishing different parts of the value chain in different locations.

In fact, with this third dimension Ghemawat makes an explicit option that Bartlett and Ghoshal had already included in their description of the transnational strategy but which they had fused into one dimension with “local responsiveness”.

Figure 2.3

AAA-Framework with Profiles of Two Companies



Source: Adapted from Ghemawat 2007, p. 66.

Focus on One or Two Dimensions

Ghemawat emphasises that companies could make progress in all three dimensions but that there are substantial tensions between them. Using all three dimensions effectively is therefore difficult and MNCs should instead make a strategic choice and prioritise their efforts, which would usually lead to a focus on one or two of the dimensions. In Figure 2.3, the model illustrates two companies in the diagnostic imaging industry.

Table 2.2

Selected Characteristics of the Three Dimensions of International Strategy

	Adaptation	Aggregation	Arbitrage
Competitive Advantage <i>Why should we globalize at all?</i>	to achieve local relevance through national focus while exploiting some economies of scale	to achieve scale and scope economies through international standardization	to achieve absolute economies through international specialization
Configuration <i>Where should we locate operations overseas?</i>	mainly in foreign countries that are similar to the home base, to limit the effects of cultural, administrative, geographic, and economic distance		in a more diverse set of countries, to exploit some elements of distance
Coordination <i>How should we connect international operations?</i>	by country, with emphasis on achieving local presence within borders	by business, region, or customers, with emphasis on horizontal relationships for cross-border economies of scale	by function, with emphasis on vertical relationships, even across organizational boundaries
Controls <i>What types of extremes should we watch for?</i>	excessive variety or complexity	excessive standardization, with emphasis on scale	narrowing spreads

Source: Ghemawat 2007, p. 61.

Detailed recommendations and considerations are made for each dimension, and examples of companies and their strategic profiles, usually focusing on two of the three dimensions, are described in Ghemawat's articles. Table 2.2 summarises a number of different characteristics for the three dimensions.

Conclusion and Outlook

The I/R-framework builds on a *tension* that is usually considered the most relevant, particularity in International Management: the *dual forces* for global integration and local responsiveness. Global efficiency on the one hand and multinational flexibility on the other hand are considered primary objectives of the MNC that are difficult to achieve simultaneously. Furthermore, worldwide learning is considered crucial for the innovation capacity of an MNC and a certain level of integration is beneficial for MNC learning.

Four MNC strategy types are proposed in the I/R-framework, each for a specific external context. While the transnational strategy is the dominant strategy recommendation in literature, most empirical studies show that few MNCs actually follow this strategy. Thus, it is an "idealized MNC model" (Birkinshaw/Morrison 1995, p. 737) rather than a common phenomenon and the exception rather than the rule.

It should be kept in mind that all the strategy types are considered adequate – under given *circumstances* – and that the complexity of a transnational strategy is ambitious and only justified if the requirements of the external environment are complex, with simultaneously high needs for global integration and local responsiveness. Unfortunately, this situation occurs more and more often and thus the transnational strategy will likely become more common in the future.

The AAA-framework shows that it is useful to explicitly investigate a third dimension of MNC strategy, arbitrage. Companies can use differences between countries by establishing different value chain activities in the optimal location. Based on the three dimensions of the framework, a myriad of MNC strategies is possible, even though it is again recommended to avoid over-complexity. Ghemawat also recommends focussing on one or two of the three dimensions, which would result in about six generic strategies.

Further Reading

BARTLETT, C.A.; BEAMISH, P.W. (2014): Transnational Management: Text, Cases, and Readings in Cross-Border Management, 7th ed., Boston, McGraw-Hill.

Transnational Strategies the Exception Rather than the Rule

Complexity Only if Necessary

Multitude of Strategies in Three Dimensions

GHEMAWAT, P. (2007): Managing Differences: The Central Challenge of Global Strategy, in: Harvard Business Review, Vol. 85, No. 3, pp. 59-68.

HARZING, A. (2000): An Empirical Analysis and Extension of the Bartlett and Goshal Typology of Multinational Companies, in: Journal of International Business Studies, Vol. 31, No. 1, pp. 101-120.

Case Study: Retailing*

The Retail Industry

The retail sector is being confronted with unprecedented changes. Originating from social and economic trends and a broader set of technologies, unconventional approaches, flexibility, collaboration and rapid learning strategies are becoming more and more important for retailers worldwide (Deloitte 2014, pp. 9-11). Even if retailing is one of the world's largest industries (Zentes/Morschett/Schramm-Klein 2011, p. 1), the sector faces intense competition, slow growth in major developed markets, volatile input prices and excess retail capacity in many developed markets (Deloitte 2014, p. 31).

While retailing has traditionally been a very local business and internationalisation has lagged significantly behind the manufacturing sector, the last two decades have seen remarkable change. A wave of internationalisation has resulted in a high level of expansion of the largest retailers (Swoboda/Foscht/Pennemann 2009). The top ten retailers operated, on average, in 16.3 countries, in 2012 and one third of their combined retail revenue originated from foreign activities (Deloitte 2014, pp. 20-30). According to Deloitte (see Table 2.3), fashion retailers had the highest international performance followed by hardlines and leisure goods. Food retailers scored last.

Wave of Internationalisation

* Sources used for this case study include the companies' web sites, various annual and company reports, investor-relations presentations as well as sources explicitly cited.

Level of Globalisation by Retail Sector in 2012

Table 2.3

	Retail Revenue from Foreign Operations	Average Countries	Single-Country Operators
Top 250	24.3%	10.0	36.8%
Fashion Goods	29.8%	22.2	23.8%
Hardlines & Leisure Goods	26.6%	13.1	26.9%
Fast-moving Consumer Goods	23.3%	5.1	44.5%
Diversified	22.6%	10.3	36.8%

Source: Deloitte 2014, p. 24.

Forces for Global Integration and Forces for Local Responsiveness

Over the last few decades, strong forces for global integration have been influencing the retail industry. These forces can be categorised in different ways, but can generally be divided into: buyer behaviour, costs, regulatory, competition and technology (Gillespie 2011, pp. 50-51).

- In different retail sectors, consumer needs have become more homogeneous around the world. This has been driven partly by cultural convergence. Increased travel and communication tools lead to a comparison of people's lifestyles and their standards of living with others. Cross-national TV series and music channels have been encouraging the notion of a global consumer (De Mooij 2003, p. 183). Moreover, the growing middle-class and disappearing income differences across countries support the *homogenisation of consumer behaviour*.
- Given that retailing is an increasingly complex business with high costs for infrastructure (stores, warehouses, IT-systems, etc.), economies of scale play a major role. An integration of activities – in particular of procurement activities – is necessary to gain *economies of scale* in procurement and to gain negotiation power over the supplier (Zentes/Morschett/Schramm-Klein 2011, pp. 321-332).
- In the past, a number of multilateral *trade agreements* have accelerated global integration. Within the EU, free trade allows retailers to transport goods from central warehouses to their stores in different countries without custom duties and other obstacles.
- Furthermore, since many retailers have started to internationalise, more and more often, different retailers are confronted with *global competition*.

Converging Consumer Needs

Costs

Trade Liberalisation

Global Competitors

ICT Technologies

Whether in home improvement retailing, in food retailing, in consumer electronics, more and more often the same companies meet as competitors in different foreign markets. To play such “global chess” effectively, a certain level of coordination is necessary.

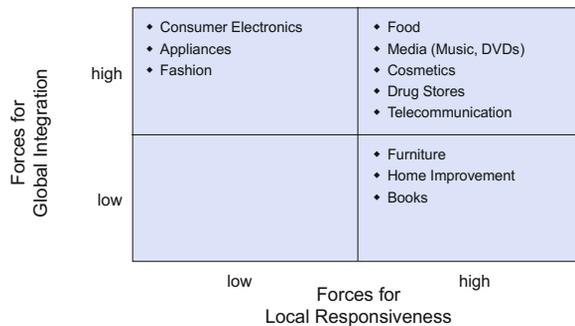
- New ICT technologies facilitate a free flow of goods and information, thus changing the retailing landscape. Information is available within seconds and enhances pricing transparency, as well as minimising cultural distance and homogenised consumer markets. Particularly store-based retailers are faced with the threat that ever more consumers will shop online in the near future, regardless of national boundaries. These *cross-border Internet sales* and delivery networks will displace more and more notorious structures (Wrigley 2010, p. 4; Deloitte 2011, pp. 3-4).

Heterogeneous Demand

On the other hand, localisation is one of the effective ways for store-based retailers to compete with e-commerce multinationals. While a trend towards convergence can be observed, consumer demand is still heterogeneous. The differences are enormous, especially concerning the new markets for retailers, like Eastern Europe, China or even India. Consequently, expenditure on clothing, electronics, appliances, etc., also differs widely. In addition, consumer tastes differ for *cultural reasons*. Whether, for instance, preferences converge concerning interior design, which influences furniture retailers and home improvement stores more and more, consumers around the world still differ.

Figure 2.4

Forces for Global Integration and Local Responsiveness in Different Retail Sectors



Convergence and Divergence

Figure 2.4 represents an attempt to categorise different retail sectors by the different *I/R-forces*. For example, in consumer electronics, consumer demand is rather similar worldwide and the standardisation of products and existence of only a few suppliers worldwide lead predominantly to the need for

global integration. On the other hand, the supply of many product categories in home improvement is still rather local, as are consumer tastes. With “transnational” requirements, food retailing is experiencing enormous cost pressure and the emergence of global competitors, leading to the need for global integration. At the same time, disparate consumer income and consumer tastes, as well as remaining trade barriers (including the relevance of freshness, which hinders long logistics chains), lead to the necessity to adapt activities to the local markets. Similarly, when considering into drug stores and cosmetics, suppliers are more and more often the same, but consumer behaviour regarding cosmetics still differs greatly. For example, while tanning creams are sold in Western countries, whitening creams are sold in cosmetic stores in Asia. The existence of different skin types, hair colours, etc., in the human population globally, requires simultaneously high global integration and local responsiveness.

Strategic Orientation of Retail Companies

The complex and varied environmental drivers described above, influence industries, especially the retail sector, and affect strategies of global integration and local responsiveness in a variety of ways (Rugman/Collinson 2012, p. 318). Apart from the primary use to map industries, the I/R-framework indicates what strategy a firm is able to pursue in an international surrounding (Westney/Zaheer 2010, p. 348). Some chains like *Walmart* and *Best Buy* have perfected the single-minded strategy of standardisation implemented in store formats, merchandise mix, operating and marketing processes. Others, like *Kingfisher* react more flexibly to serve consumer differences (Guan 2010, p. 2).

As an example of a generally global orientation, *Hollister*, a subsidiary of *Abercrombie & Fitch*, can be used. Founded in 2000, it is designed to attract teenagers aged between 14 and 18 years. Built on a fictional background, the story of *Hollister* claims that J.M. Hollister founded the company in 1922 to bring the “Southern California Lifestyle” to the world. This vision is evident in the assortment as well as in the store layout and becomes the core of the retailer. Starting with the first store in Columbus, Ohio, the retailer operates today in many different countries with more than 580 stores worldwide. In addition to the bricks and mortar locations, the first online shop in the USA was launched in 2003. Today there are more than 60 stores across the UK, Germany, Italy, Spain and other locations within Europe.

Hollister pursues a *globally centralised strategy* worldwide. All strategic processes like procurement, marketing activities and human resources are centred and managed by the headquarters in New Albany, Ohio. Both exterior and interior store layout remind the consumer of a surf atmosphere, looking

Global Orientation

like beach huts or consisting of a series of video monitors which reflect the scene of *Huntington Beach*. The interior is dimly light with spotlights, scented with the company's fragrance and equipped with a lounge area. In total, the corporate policy establishes the design, furniture, fixtures, music as well as the look of the sales associates and the merchandise presentation. Everything is carefully planned and coordinated by the company to create a consistent and unique shopping experience reflecting the *Hollister* lifestyle and conveying the principal elements as well as the personality of the brand. Apart from all that, an official manual describes the look of the employees, called store models, and instructs them which items can be worn together, and how to style them. Officially, customers should be addressed in English and the presented assortment is specified by the headquarters and changes every two months.

The two distribution centers located in New Albany, Ohio, manage the receipt, storage, sorting, packing and distribution of merchandise for the North American stores and Asian direct-to-consumer customers. *Hollister* also uses a *third-party distribution center* in the Netherlands to manage the receipt, storage, sorting, packing and distribution of merchandise delivered to stores and direct-to-consumer customers in Europe and a third-party distribution center in Hong Kong for the stores in Asia.

The global orientation enables *Hollister* to open new stores efficiently, but in addition, the strategy guarantees cost savings regarding store furniture and maximises the usage and productivity of selling space.

Transnational Orientation

As an example of a transnational orientation, *7-Eleven*, the world's largest operator, franchisor and licensor of *convenience stores*, is useful. Established in 1927 in Dallas, Texas, the company was rescued from bankruptcy in 1980 and became a subsidiary of the Japanese company *Seven & I Holding* in 2005. Today *7-Eleven* has almost 50,000 stores across the globe with the same branding and is located in more than 16 countries worldwide. Known as a convenience store where customers can buy snacks, drinks and other everyday products on the go, almost all *7-Eleven* stores are operated by franchisees. The company combines centralised processes with respect to local advantages. With regard to the product strategy, the company focuses on drinks and ready-to-eat food, but also caters for local tastes. Customers in Hong Kong can buy fresh pasta snacks or even pay their phone bills. In Taiwan they can pay traffic tickets, pump up bicycle tires and send or receive packages. The product-mix of *7-Eleven* is based on consumer analysis which the company uses in plans for products and services. The marketing team consequently searches and selects products and services which satisfy the demands of different target groups and are in line with new trends and markets changes.

One of the benefits of the transnational strategy is the (only) marginal adaption of the format – the retailer can open stores with and without gasoline, urban walkup stores or stores in strip center – another is the “retail information system”, which allows the retailer to follow on trends more quickly than competitors. The typical store is located in office areas, open 24 hours and comprises a sales area of about 100 square meters with a wide variety of goods. The stores are categorised into three types: First, *corporate stores* which are owned and managed by the company. *7-Eleven* invests in retailing equipment, store decoration and inventory. Second, within the *franchise stores*, *7-Eleven* is responsible for investment in retailing equipment, store decoration and inventory. Third, the *sub-area licence store* where *7-Eleven* provides only assistance and support (Ngaochay/Walsh 2011, p. 148). Data collected by the company responds to consumer needs in a timely manner, improves the line of products and develops new products accordingly, strengthens procurement power and sales forecasting, and devises targeted marketing strategies. The information system also enables store owners to learn the characteristics of the business districts in which they operate, place accurate orders and minimise inventory.

In addition, *7-Eleven* has a centralised logistics management, serving a high number of stores which are systematically opened within a certain area to enhance distribution efficiency, greater familiarity with customers and effective sales promotion. The distribution system is based on an item-by-item and temperature-separated, combined distribution center for each area.

The key to *7-Eleven's* successful model is to enact a centralised business strategy to leverage the company's buying power, marketing strategy and operative processes through an adaption to local needs based on an information system which shows changes as soon as they occur.

With total revenue of 42 billion EUR and more than 14,800 stores in different countries, the *REWE Group* is the second largest food-retailer in Germany and serves as an example of a multinational strategy. Established in 1927 and registered as a cooperative, the company nowadays operates with a variety of sales lines within their two core businesses divided into trading and travel & tourism. Due to increasing market expansion, the centralised structure with a concentration of processes in the headquarters, became more and more obsolete. In 2007, the *REWE Group* reorganised its structure to a more decentralised one. More regional autonomy, flexibility, agility and an orientation towards customers were central aspects of the *restructuring process*. Management steering roles were moved from central corporate departments to strategic business units. All decisions pertaining sales, sales-line purchasing, marketing, expansion, controlling human resources or accounting are made by those responsible for operative results. *Strategic business units* are National Full Range Stores, National Discount Stores, International Full-

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Orientation*

Range Stores, International Discount Stores, National Specialist Stores, Travel Sales, Package Tourism and Component Tourism. Central functions for competitive success are decentralised and centred in these units.

With different store brands in twelve countries, *REWE* serves more than 70 million customers per week. In Germany, the company maintains several formats like *REWE*, *toom getränkemarkt*, *nahkauf*, *TEMMA* and *PENNY*. Austria is served by the full-range stores named *Billa* (supermarket), *Merkur* (superstore), *ADEG* (supermarket), *BIPA* (drug store) and the discount format *PENNY*. By contrast, in Bulgaria, the group concentrates on the supermarket *Billa* and the discount store *PENNY MARKET*. While the expansion to East Europe is dominated by the retail formats of *Billa* and *PENNY MARKET*, indicating a standardised expansion, Romania differs from this course and underlines the partly differentiated strategy. Since 2001, the retailer represents itself with two discount formats, *PENNY MARKET XXL* (sales area up to 2,500 square meters) named *XXL Mega Discounter* since 2013, and the above mentioned *PENNY MARKET* format.

Depending on retail units and countries, the assortment differs partly within the organisation. Additionally, the working clothes of employees and the store layout of the individual formats also vary across the different units.

At the same time, strategic purchases at the group level will be continued to enhance the position of the *REWE Group* on national and international procurement markets.

International Orientation

An example of using an international strategy is *Alnatura*, a German retailer of organic and ethical products. Established in 1984, the retailer nowadays maintains about 87 stores in more than 40 cities. Almost 2,150 employees work for the company and *Alnatura* achieved an annual turnover of 593 million EUR in 2012/2013.

Standing for an organic lifestyle, *Alnatura* offers a wide range of products in its supermarket format. Known for its private label "*Alnatura*", with around 1,100 products, the retailer also provides a wide range of local products from different and regional partners. A total of 6,000 articles are offered in an ordinary *Alnatura* supermarket. As mentioned above, the company focuses on highly collaborative strategy and works together with centralised distribution centres and local partners. The stores are supplied by regional wholesalers and regional manufacturers or farmers, e.g. organic bakeries. The store area is about 600-800 square meters and the layout reflects the ecological awareness of the company with natural stone tiles on the ground, natural colouring on the walls and wooden shelves.

In 2012, *Alnatura* started its *international expansion* and has been serving the Swiss market in cooperation with the local retailer *Migros* since then. In

contrast to the German branding, the brand appearance is known as *Alnatura-Migros*, a co-branding of both retailers, which implies both centralised and decentralised aspects. The association is based on the strength of *Alnatura*, which implies the wide assortment and position of *Migros* in Switzerland. The assortment range contains, as in Germany, local products from local partners. Furthermore, there are imported brands like *Rapunzel* and organic products of *Migros*. The *Alnatura* concept was partly adapted to local conditions, but also contains elements of a standardised procurement policy. The strategy is similar to that in Germany, but the assortment comprises 5,000 articles instead of 6,000. The *Alnatura-Migros* cooperation has opened two additional stores and plans to open 20-30 new stores within the country in the nearest future. Looking at the branding, *Alnatura* has the standardised look of the brand in Germany and a co-branding with *Migros* in Switzerland.

Focusing on a special target group with homogenous consumption patterns, often called as *LOHAS (Lifestyle of Health and Sustainability)*, *Alnatura* is not committed to serving specific local needs, nor any general requirements.

In Table 2.4, the findings described above are summarised. Depending on the orientation, every retailer has specific focuses and emphasises individual models of international market cultivation.

Retailers and Their Strategic Orientation

Table 2.4

	Hollister	7-Eleven	REWE Group	Alnatura
Brand	globally standardised	globally standardised	locally integrated	locally integrated
Marketing Strategy	globally standardised	between global standardisation and local integration	locally integrated	-
Store Layout	globally standardised	between global standardisation and local integration	locally integrated	globally standardised
Assortment	globally standardised	between global standardisation and local integration	locally integrated	between global standardisation and local integration
Distribution	Globally standardised	locally integrated	globally standardised with local Integration	between global standardisation and local integration

Summary and Outlook

This Chapter has shown that retailing is becoming increasingly international, resulting from different external and internal influences. Depending on expansion activities and organisational structures, retailers have to choose

whether they follow a more global, local or combined strategy. Both the more integrated and more local approaches can bring success, depending on the sector and individual environments. As shown in the case studies, a strictly application of the theoretical model is often not feasible in practice, due to unpredictable individual factors and the complex environment. Thus, a dynamic development of the I/R-strategy on all relevant levels is necessary.

Questions

1. Describe the main critics of the I/R-framework.
2. Compare *Louis Vuitton's* strategy with *Fressnapf's* strategy, regarding the I/R-framework. What are the main conflicts for retailers using a strict interpretation of the characterised orientations?
3. Evaluate the strategic I/R-orientation of different multinational consumer goods' producers. To what degree are activities different to retailers?

Hints

1. See, e.g., Zentes, Morschett and Schramm-Klein 2011.
2. Examine the respective company websites: www.lvmh.com, and www.fressnapf.com.
3. See, e.g., Cavusgil, Knight and Riesenberger 2014.

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