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Introduction and Overview of the Book's Framework

Senior managers in multinational enterprises (MNEs) have a healthy appetite for knowledge that will improve their firm's performance. They want to know which models from the international business strategy literature can actually be applied in their own firm.

Rethinking the Classics in International Business Strategy

Many MNE senior managers hold (or pursue) MBA or executive MBA degrees, and they certainly read whatever is of use in publications such as the *Financial Times*, the *Wall Street Journal*, *The Economist*, *Business Week*, and *Fortune*. When these managers seek practical advice on improving multinational operations, however, one publication stands out: the *Harvard Business Review* (*HBR*).

For at least the past thirty years, *HBR* has published the frontier knowledge on everything that really matters to senior MNE managers. This explains why so many classroom readers include reprints of *HBR* articles, and why so many international management teachers use *HBR* articles in their classes. Apart from the *Harvard Business Review*, two other academic publications are highly relevant to managers: the *MIT Sloan Management Review* (*SMR*), published by the Massachusetts Institute of Technology (MIT), and the *California Management Review* (*CMR*), published by the Haas School of Business at the University of California at Berkeley.

The first articles on globalization and its impact on MNE strategy appeared in the early 1980s. The growing economic interdependence between nations – especially the rise of the Triad of the United States, Europe, and Japan (replacing post-World War II US hegemony) – drove much of this work. Subsequently, emerging economies became more important, most notably China with its own hegemonic ambitions. Since the early 1980s, *HBR* has published several outstanding and now classic research papers on how to improve MNE strategy. The

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two other key journals, *SMR* and *CMR*, have also published useful, complementary perspectives on the same international business subjects. Senior managers like these articles because they are well written, insightful and practical: they lead directly to improved managerial practice.[1]

Although we have used these articles with great success in our own MBA and Executive MBA classes, both students and MNE executives think there is great value in a general, unifying framework that managers can use to interpret and synthesize the valuable, practical knowledge contained in the articles. This book tries to provide such a framework; it is a synthesis of the best ***practitioner-oriented*** work in international business.

Such a synthesis might seem to be an impossible task, as there are as many views on international business strategy as there are people writing about it.[2] Nevertheless, we think that most of international business strategy can be captured by just a few simple concepts. Differences among authors are usually just variations on these central themes.

The structure of the book is as follows. In Chapter 1, we lay out the main building blocks of the unifying framework used throughout the book. This framework should allow MNE senior managers to grasp the essence, in strategy terms, of what happens in a complex international business setting.

In addition to describing managers' possible strategies, the framework of Chapter 1 also makes normative suggestions about which strategies are most effective. Most notably, the framework suggests how to improve MNE performance in two areas: value creation and satisfying stakeholder goals across borders. This normative approach is warranted because many MNEs can learn substantially in the short run from best practices adopted by other companies, and in the long run only firms adopting such best practices will survive. As much as possible, we try to specify the preconditions that must be fulfilled for these specific normative suggestions to be valid, often informed by our own research and consulting experience with senior MNE managers. Insufficient specification of when particular normative suggestions will actually improve performance, and when they will not, is probably the most common criticism voiced against articles published in *HBR*, *SMR*, and *CMR*. This is a trap we try to avoid in the present book.

In Chapters 2 to 17, we discuss what we consider to be the best international business articles published in *HBR*, *SMR*, and *CMR* since the early 1980s, and we systematically refer to the unifying framework. After starting each chapter by discussing a classic article in one of the practitioner journals, we then extend the analysis by describing the additional insights gained from articles published in the other journals. We think that this extensive use of practitioner-oriented journal articles has produced a book that is more practitioner-friendly than most of the existing books on international business strategy.

The book is divided into three parts: core concepts (Chapters 1 to 5), functional issues (Chapters 6 to 10), and the dynamics of global strategy (Chapters 11 to 17).

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Chapter 17 has two distinct parts. Both parts address the broader responsibilities of MNEs, beyond satisfying the demands of their three main stakeholder groups (shareholders, customers, and employees). Part A addresses corporate social responsibility. Part B discusses MNE environmental sustainability. In the book's Conclusion, we briefly address a few key implications of the book's analysis for MNE managers to help them respond better to both the challenges and the unprecedented opportunities of managing international operations.

This book does not limit itself to a specific country or industry context. Such context is obviously important, as suggested by the many examples from practice, but managers should be able to apply the key concepts developed in this book to a wide variety of country and industry settings.

We assume that the reader has a basic understanding of strategic management concepts as developed for domestic contexts. Our purpose, however, is not simply to add an incremental 'international dimension' to the discussion of a set of conventional strategy problems. Our goal is to explain what lies at the heart of a successful international business strategy, through rethinking a large number of classic articles in international management, and thereby the foundations of global corporate success.

Five Changes in the Third Edition

We have made a number of changes to the book while preparing this third edition, based on the suggestions made by senior scholars who have adopted it in their courses at leading business schools. We would like to highlight the following five changes.

First, we have replaced our discussion of sixteen articles from the second edition with analysis of newer articles published during the 2010–2019 period that appeared more relevant to the present practice of management in internationally operating firms.

Second, we have added a new section, entitled 'Strategic Challenges in the New Economy', at the end of each chapter. In these sections, we discuss twenty-one new articles (eighteen from *HBR*, two from *SMR*, and one from *CMR*) with a particular focus on new challenges in international business strategy. Many of these address complexities arising from the growth of the digital economy and from the deployment of more complex business models across borders.

Third, at the end of each chapter from Part I on core concepts (Chapters 1 to 5), we have included a new section, entitled 'International Business Strategy During Globally Disruptive Events'. Our writing of these sections was informed mainly by the 2020 COVID-19 pandemic, but we draw insights from this pandemic that are relevant to preparing for other global environmental shocks.

Fourth, we have added a new Chapter 16 entitled 'Multinational Entrepreneurship', to analyze the phenomenon of small and young firms' early internationalization from the perspective of international business strategy.

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Fifth, all the case studies from the second edition have been updated where relevant, but we have placed these cases online to complement the third edition, thereby allowing easy further updating, where relevant.

Definition of International Business Strategy

International business strategy means effectively and efficiently matching an MNE's internal strengths (relative to competitors) with the opportunities and challenges found in geographically dispersed environments that cross international borders. Such matching is a precondition to creating value and satisfying stakeholder goals, both domestically and internationally.

The above definition focuses on the MNE, a firm with economic operations located in at least two countries. This book will also note some of the special opportunities and challenges that arise when doing business across regions, such as those created by the European Union (EU) and the United States–Mexico–Canada Agreement (USMCA). 'Matching' does not mean that this book proposes a set of easy how-to-do-it prescriptions. Rather, this book intends to educate and further sharpen the intuition of MNE senior managers, when faced with strategic opportunities and challenges in international environments. As regards the relevant stakeholders, we consider satisfying the requirements of the firm's shareholders, its customers, and its employees (including managers) as equally important, though there may obviously be conflicts among the goals of each stakeholder group, and within each stakeholder group – especially between domestic and foreign stakeholders. Many stakeholder groups other than shareholders, customers, and employees may be relevant in terms of their potential impact on value creation, but we consider them secondary as compared to the three main groups. Shareholders and employees provide the inputs most critical to the MNE's functioning, and success can ultimately only be achieved if customers purchase the firm's products. However, a key feature of the new digital economy is that the boundaries between primary and secondary stakeholders sometimes become blurred. For example, many contributors to innovation in digital companies may not be formal employees, but can still be long-term partners of the MNE.

The Seven Concepts of the Unifying Framework – a Brief Overview

Most complex issues in international business strategy revolve around just seven concepts (Figure I.1). Differences among authors are usually just variations on these central themes. These seven concepts form a unifying framework that

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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 I.1)
6. Bounded rationality
7. Bounded reliability

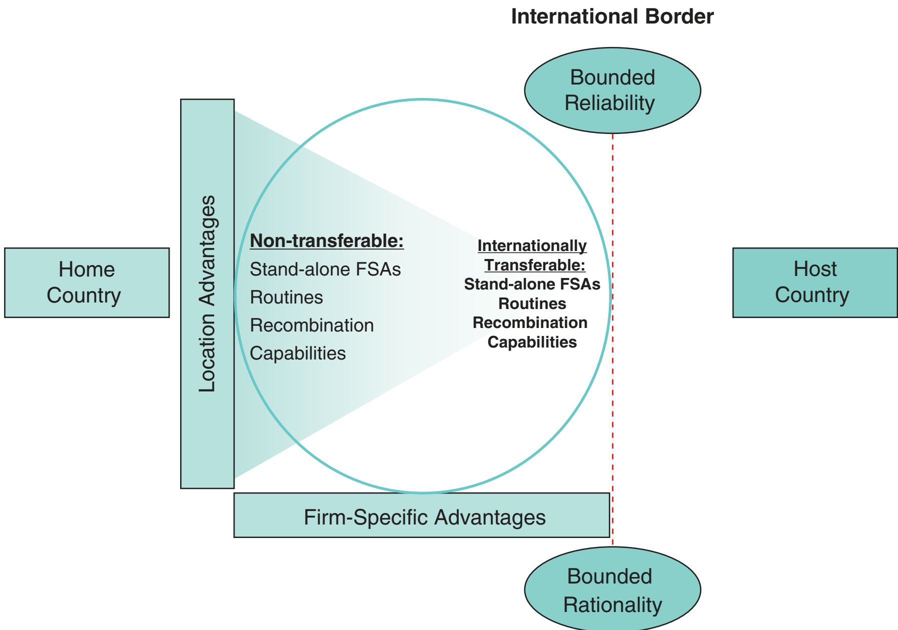

Figure I.1 Core concepts

The triangle in the model represents the 'pyramidal' nature of the firm's advantages. Upon the broad base of home country external location advantages (LAs), i.e., the vertical rectangle on the left-hand side in the home country space, the MNE selectively builds a narrower and distinct set of FSAs that are location-bound (LB; the middle space in the pyramid), and then a typically even narrower initial set of FSAs that are non-location-bound (NLB; the top of the pyramid pointing to the international border). The circle represents the actual usage of the company-level FSAs in the home country milieu. Bounded rationality and bounded reliability constraints will influence the firm's strategy for transferring, deploying, and exploiting effectively its non-location-bound FSAs across borders (e.g., operating mode choices).

The ***first three concepts*** above (***internationally transferable FSAs***, ***non-transferable FSAs***, and ***location advantages***), as a set, reflect the distinct resource base available to the firm, critical to achieving success in the marketplace.

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In this book, the firm is viewed as essentially a bundle of resources under common governance.[3]

Expressed in practical, managerial terms, this resource base has various components, either owned by – or accessible to – the firm:

1. Physical resources, including natural resources, buildings, plant equipment, etc.
2. Financial resources, including access to equity and loan capital.
3. Human resources, including both individuals and teams. These individuals and teams have both entrepreneurial and operational (or efficiency-related) skills.
4. Upstream knowledge, including sourcing knowledge, as well as product- and process-related technological knowledge.
5. Downstream knowledge, critical to the interface with customers, and related to marketing, sales, distribution, and after-sales service activities.
6. Administrative (governance-related) knowledge regarding the functioning of the organizational structure, organizational culture, and organizational systems.
7. Reputational resources, including brand names, a good reputation for honest business dealings, etc.

A firm can have FSAs – i.e., strengths relative to rival companies – in each of the above resource areas. The nature, level, and contestability of these strengths vis-à-vis rivals is not always fully understood by outsiders, but these strengths should, in principle, be identifiable through a properly conducted benchmarking exercise. The firm's particular location may contribute significantly to this distinct resource base, especially if this location provides privileged access to specific resources external to the firm itself. Thus, FSAs and location advantages can be intimately related. For example, FSAs such as patents in the upstream knowledge area, or brand names in the reputational resource area, confer value only if supported by a favourable property rights regime (patent laws, trademark protection, etc.) that protects proprietary knowledge. The specifics of the property rights regime are different in each nation, and can thus represent a location advantage for firms with substantial proprietary knowledge and operating in countries with a favourable regime, in this case institutionalized through government intervention.

Routines reflect the distinct ability to combine further the above resources, in unique ways valued by the firm's stakeholders. Routines are stable patterns of decisions and actions that coordinate the productive use of resources, and thereby generate value, whether domestically or internationally. The combination ability expressed in routines is a higher-order FSA, because routines are more complex than an FSA derived from distinct but stand-alone resources. Therefore, rival companies face more difficulties imitating or otherwise acquiring it.

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Case example Consider the classic example of Federal Express' mail delivery system. Frederick W. Smith founded Federal Express in 1971, based on his innovation of the 'hub-and-spoke' approach to mail delivery. In a change from the traditional direct shipping from origin to destination, Federal Express developed a new routine: it first gathered all mail in its hub in Memphis, Tennessee, sorted the mail there, and then shipped it from the hub to a variety of final destinations. Using this hub-and-spoke routine, the company was able to provide overnight delivery services with fewer trucks and planes.

Building upon this simple hub-and-spoke concept, Federal Express created multiple business processes, such as a sophisticated tracking and tracing system to monitor the routing of each item, a customized weather forecasting system to aid in-flight scheduling, fleet management systems for its planes and trucks, and a distinct management approach to its network of distributors. Although many competitors tried to copy these routines in the 1980s, Federal Express remained the industry leader.[4] It is important to understand that early entrepreneurial judgement was critical here. Mr Smith invented the hub-and-spoke model in an undergraduate essay he wrote at Yale University, and the idea of combining fleets of aircraft and trucks to create seamless logistics chains came from his service with the US Marines, which combined air and ground equipment in their military operations.[5]

Federal Express also applied the above routines when expanding internationally. For example, when Federal Express entered China, it rolled out its key routines, covering the entire upstream and downstream areas of the firm's value chain. It transferred its prevailing management systems, bought its own planes for this market, acquired its own air routes, and tried to establish its own network of distributors. As noted by T. Michael Glenn, Executive Vice President for marketing at FedEx's parent, FDX Corp, 'We've got a pretty good formula for attacking any market . . . Whether it's China or Japan or Germany, it really doesn't make any difference.'[6]

Compared with an FSA derived from a single, stand-alone resource, a capability to combine resources may be more flexible and durable, because it often involves substituting one resource (such as a high-quality human resource or a type of equipment) for another, similar, one without loss of long-term productive value. The combination capability may also guarantee the continued control over distinct, stand-alone resources, such as human resources, when it allows both higher productivity benefiting the firm and higher rewards to these distinct resources than they could earn outside of the firm.

Transferring and exploiting a routine across borders may pose problems, however, if the routine is not fully understood by either the source in the home country or the recipient in the host country, even if it has been deployed frequently and reliably in the home country. Failure to fully understand a routine typically occurs if the routine has a 'cultural' component. In such cases, the routine relies on a distinct, national cultural characteristic which may not be present in host country environments. ■

Case example As another classic example, Cisco, headquartered in the United States, is the world's largest networking equipment manufacturer. In 1994, it began the implementation of an enterprise resource planning (ERP) system and by 1998 was poised to focus its attention on

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the Chinese market. Cisco had garnered first-mover advantages and continued to maintain a considerable reputation with a single system image on a completely Web-based platform throughout the world.[7]

However, the local management in China identified a number of issues of local adaptation that could threaten the effective adoption of the common system platform and damage Cisco's market reputation (e.g., a need for Chinese character-based financial statements). Cisco listened to the advice of its local representatives and ultimately adapted successfully to the idiosyncratic requirements of the local Chinese workplace by, among other things, producing Chinese character-based financial statements. ■

The simple point made by this last example is that knowledge management systems themselves, though at the heart of knowledge transfer within MNEs, may face a variety of problems when diffused throughout the MNE network. Importantly, the failure to transfer these types of routines effectively may have broader spillover effects on the MNE as a whole.

International transfer difficulties in part reflect the presence of generic differences, including cultural differences, between home and host countries (these differences require adaptation and a recombination capability, as explained below). In addition, another common transfer difficulty is that those supposed to implement a practice abroad lack a crucial piece of experiential knowledge. This problem is sometimes compounded by the lack of sufficient attention to the routine's tacit knowledge attributes by those supposed to transfer the practice from the source country.

The ***fourth concept***, ***recombination***, constitutes the heart of international business strategy: international corporate success requires more than just routines, whether internationally transferable or location-bound ones, that allow for stable and predictable patterns in combining resources. The highest-order FSA is the ability not just to combine reliably the MNE's existing resources, but to recombine its resources in novel ways, usually including newly accessed resources, whether in a limited geographic space (in which case the firm engages in domestic product diversification or innovation) or internationally. In the international context, MNEs must engage in the artful orchestration of resources, especially knowledge bundles, as a response to differences between national and foreign environments, and to satisfy new stakeholder demands in these foreign environments. In practical terms, entrepreneurial judgement is at the heart of the MNE's recombination capability: individuals inside the MNE act as entrepreneurs and craft new ways of combining and deploying the resources under their control as a response to perceived business opportunities. It is important to understand that recombination does not just mean adding new resources and managerial practices to existing ones: recombination means by definition foregoing at least some standard resources and standard practices before a new business opportunity can successfully be acted upon. A resource

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recombination capability is thus a precondition to value creation and satisfying stakeholder needs when operating in complex international settings.

The ***fifth concept***, ***complementary resources of external actors***, represents the additional resources, provided by external actors but accessible to the MNE, which may be necessary to fill resource gaps and achieve success in the marketplace. This book will focus solely on the complementary resources provided by external actors that are critical to international success.

Finally, the ***sixth*** and ***seventh concepts***, ***bounded rationality*** and ***bounded reliability***, reflect the behavioural characteristics (of both senior MNE managers and other relevant economic actors) that may impede international success. Bounded rationality implies limits to the capacity of individuals to absorb, process, and act upon complex and often incomplete information. Bounded reliability implies insufficient effort to deliver on promised behaviour or performance. As this book will demonstrate, acute problems of bounded rationality and bounded reliability characterize many international business decisions and actions.

This book discusses in much more detail the complexities associated with each of these seven concepts, as well as the sometimes subtle linkages among them.

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