Transcription Lesson 4 (AAA strategies)

The AAA framework offers three approaches to global value creation – adaptation, aggregation, and arbitrage.

Adaptation strategies aim to up revenues and market share by customising one or more parts of a company's business model to suit local needs. *Aggregation* strategies focus on achieving economies of scale or scope by creating regional or global efficiencies; they typically involve standardising a significant portion of the value proposition and grouping together development and production processes. *Arbitrage* is about exploiting economic or other differences between national or regional markets, usually by locating separate parts of the supply chain in different places.

Adaptation is probably the most common strategy because some degree of adaptation is needed for almost all products. The taste of Coca-Cola in Europe is different from that in the United States because there are differences in water quality and the kind and amount of sugar added. Cement pricing is different according to geographies because it has different local energy and transportation costs.

There are five categories of adaptation: variation, focus, externalisation, design, and innovation.

Variation strategies not only involve making changes in products and services but also adjusting policies, business positioning, and even expectations for success. The product dimension will be obvious: Whirlpool, for example, offers smaller washers and dryers in Europe than in the United States, reflecting the space constraints prevalent in many European homes. Adapting policies is less obvious. An example is Google's dilemma in China to conform to local censorship rules.

A second type of adaptation strategy uses a *focus* on products, geographies, vertical stages of the value chain, or market segments as a way of reducing the impact of differences across regions. A product focus takes advantage of the fact that wide differences can exist within broad product categories in the degree of variation required to compete effectively in local markets. An example is TV programs: action films need less adaptation than local newscasts. Restriction of geographic scope can permit a focus on countries where relatively little adaptation is required. A vertical focus strategy involves limiting a company's direct involvement to specific steps in the supply chain while outsourcing others. Finally, a segment focus involves targeting a more limited customer base. Rather than adapting a product or service, a company using this strategy chooses to accept the reality that without modification, their products will appeal to a smaller market segment or different distributor network from those in the domestic market. Many luxury goods manufacturers use this approach.

Whereas focus strategies overcome regional differences by narrowing scope, *externalisation* strategies use strategic alliances, franchising, user adaptation, or networking to hand over responsibility for specific parts of a company's business

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model to partner companies. This allows the MNE to accommodate local requirements, lower cost, or reduce risk. For example, McDonald's uses franchising as well as company-owned stores.

A fourth type of adaptation focuses on *design* to reduce the cost of, rather than the need for, variation. Manufacturing costs can often be achieved by introducing design flexibility to overcome supply differences. Introducing standard production platforms and modularity in components also helps to reduce cost. A good example of a company focused on design is Tata Motors, which has successfully introduced a car in India that is affordable to a significant number of citizens.

A fifth approach to adaptation is *innovation*, which can be characterised as improving the effectiveness of adaptation efforts. For instance, IKEA's flat-pack design, which has reduced the impact of geographic distance by cutting transportation costs, has helped that retailer expand into 3 dozen countries.

Aggregation is about creating economies of scale or scope as a way of dealing with differences – recall the global strategy discussed in earlier in the lesson. The objective is to exploit similarities among geographies rather than adapting to differences but stopping short of complete standardisation, which would destroy concurrent adaptation approaches. The key is to identify ways of introducing economies of scale and scope into the global business model without compromising local responsiveness.

Adopting a regional approach to globalising the business model—as Toyota has so effectively done—is probably the most widely used aggregation strategy. Regionalisation or semiglobalisation applies to many aspects of globalisation, from investment and communication patterns to trade. And even when companies do have a significant presence in more than one region, competitive interactions are often regionally focused. The increased use of global (corporate) branding over product branding is a powerful example of creating economies of scale and scope.

Geographic aggregation is not the only avenue for generating economies of scale or scope. Other, nongeographic dimensions in the CAGE framework — *cultural, administrative,* and *economic* — also lend themselves to aggregation strategies. Major book publishers, for example, publish their best sellers in but a few languages, counting on the fact that readers are willing to accept a book in their second language and relying on cultural aggregation. Pharmaceutical companies using administrative aggregation satisfy the regulatory requirements of a few selected countries in Europe to qualify for a license to distribute throughout the EU. As for economic aggregation, the most obvious examples are provided by companies that distinguish between developed and emerging markets and, at the extreme, focus on just one or the other.

The third generic strategy for creating a global advantage is *arbitrage*. Arbitrage is a way of exploiting differences, rather than adapting to them, and defines the original global strategy: buy low in one market and sell high in another. Wal-Mart saves billions of dollars a year by buying goods from China. Less visible, but equally important, absolute economies are created by greater differentiation with customers and

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partners, improved corporate bargaining power with suppliers or local authorities, reduced supply chain and other market and nonmarket risks, and through the local creation and sharing of knowledge.

Since arbitrage focuses on exploiting differences between regions, the *CAGE* framework comes into play again and helps define a set of substrategies.

Favourable effects related to country or place of origin have long supplied a basis for *cultural* arbitrage. For example, an association with French culture has long been an international success factor for fashion items, perfumes, wines, and foods. Legal, institutional, and political differences between countries or regions create opportunities for administrative arbitrage. An MNE can lower its tax liabilities in the USA, for example, by locating holding companies in countries with favourable tax rates and placing ownership of acquisitions under these holding companies.

Geographic arbitrage – where MNEs leverage geographic differences – can occur frequently in medicinal industries. It is common for doctors in South Africa to take X-rays during the day, send them to radiologists in India for interpretation, and for the report to be available the next morning.

In a sense, all arbitrage strategies that add value are "*economic*." In this case, the term economic arbitrage is used to describe strategies that do not directly exploit cultural, administrative, or geographic differences. Rather, they are focused on leveraging differences in the costs of labour and capital, as well as variations in more industry-specific inputs (such as knowledge) or in the availability of complementary products.

Exploiting differences in labour costs is probably the most common form of economic arbitrage. This strategy is widely used in labour-intensive (garments) industries as well as high-technology (flat-screen TV) industries.

The AAA framework can be displayed as a triangle, and managers need to plot their approach carefully. It is not possible to do all three strategies – each has characteristics that might be in conflict with another. Instead, managers must determine what their needs are when entering a market and prioritise according to those needs.

Let's take a look at Starbuck's entry into India as an example. The company entered India through a 50:50 Joint Venture with local Tata Global Beverages. Already, this is a strong indication of an adaptation strategy. The company continued to follow a robust adaptation strategy, maximising local relevance and satisfying Indian market needs. Traditionally, India is a tea-drinking country, with a low coffee culture compared to the West, where coffee is often an on-the-go beverage. Starbucks adapts its products and menu by creating Indian-flavoured options, as well as localised merchandise items such as mugs, leveraging on the spending per person and motivating repeated visits. However, global standardised elements remain in the store design. As a result, we can rate the scale of adaptation as medium to high.

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Referring to aggregation, Starbucks does deploy the this strategy. It enters new markets using a standardised model, which leads to a similar store layout and management practice. The combination of adaptation and aggregation contributes to a tailored, but at the same time, standardised experience of consumption that people look for in the Starbucks brand. Starbucks uses the same Swiss branded coffee machine almost everywhere as a critical resource, which is considered as a secret weapon. This enables cost-efficient operation, training, and maintenance supported by a global purchasing system of most goods, underlining an aggregation strategy. Standardised operations allow the efficient launch of stores, efficient production techniques, and high bargaining power when purchasing equipment and store interiors. At a more localised level, Starbucks aggregates through focusing primarily on centres allowing to run several outlets in the same city. They exploit economies of scale by creating regional operations, instead of purely global, with notable adaptation in India. As a result, they score a medium on the scale of aggregation.

As has been emphasised, a single MNE cannot achieve every strategy of the AAA typology. As a reminder, Arbitrage exploits differences between markets, often by splitting processes of the value chain among different locations and diversifying levels of production costs and expertise as a result. Starbucks sells merchandise from around the world in its stores, produced in just a few factories. In India, a Westernised product is sold at a high price, while at the same time production inputs such as labour remain at a local level. Starbucks' Westernised product is sold for a price above the substitutes' price levels, produced under low-cost conditions, indicating slight arbitrage elements in Starbuck's strategy. The exploitation of small differences between markets indicates limited arbitrage.

Starbucks' market entry strategy can therefore be mapped on the adaptation – aggregation – arbitrage framework as follows. As you can see, they have pursued a combination of a strong adaptation strategy with a lessor aggregation strategy, sacrificing the benefits of arbitrage. We can therefore argue that Starbucks is following a transnational strategy.

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