



11

Diversified, Global, and Other Types of Organizations

Learning Objectives

By the time you have completed this chapter, you should be able to do the following:

- Understand the added complexities involved in strategically managing both multibusiness and diversified corporations.
- Appreciate the different strategies an international corporation can use to expand its markets and the difficulties involved in the strategic management of international and global corporations.
- Appreciate the differences between a business plan and strategic planning for startup companies.
- Learn how small businesses with meager resources can do strategic management (and why they don't).
- Understand how strategic management of nonprofit organizations differs from that of for-profit corporations.

Chapter Outline

- 11.1 Multibusiness and Diversified Corporations
- 11.2 International Corporations
- 11.3 Global Corporations
- 11.4 Startups and Small Businesses
- 11.5 Nonprofit Organizations

The discussion to this point through the first 10 chapters has intentionally focused on single-business, single-country corporations, which are the least complex of organizations to illustrate the model of strategic management and strategic planning expounded in this book. That knowledge can help you work through the additional complexities presented by multibusiness and diversified corporations, and international and global corporations.

Entrepreneurial organizations have to be focused on entering the market with a better product or service and in fact need a business plan, not a strategic plan. Small businesses, whether intent on growth or “Mom and Pops,” are handicapped by insufficient funds and experience of the owners. Finally, nonprofit organizations lack a profit motive, are financed in part or wholly by third parties (principally grants or philanthropy), and are driven by causes; they present a very different strategic-management challenge.

11.1 Multibusiness and Diversified Corporations

This discussion so far has focused on single-business corporations or **strategic business units (SBU)** that compete in a specific industry with specific competitors. They require unique strategies and financial resources to enable them, with someone, typically the CEO, accountable for what is achieved. Both multibusiness and diversified corporations operate more than one business, that is, have more than one strategic business unit (SBU). By extension, a **multibusiness corporation** is one that owns more than one SBU or is in more than one business.

Why might a company want to operate a second SBU? It might want to pursue an opportunity in another industry or follow through on a different application of a technology it owns. Running a second SBU typically means being in a different industry or a substantially different segment of the same industry. If a men’s jeans manufacturer wants to produce jeans for women, is that another business? No. If the same men’s jeans manufacturer wants to produce denim jackets for men, is that another business? Again, the answer is no. However, in the latter case, it would morph from a jeans manufacturer into an apparel manufacturer to reflect the change. Since jeans is apparel, the “business” it’s in wouldn’t change. But manufacturing or even distributing anything that wasn’t apparel would mean getting into another business. For example, Levi’s did not create another business with the creation of its Dockers brand; the new identity still represented a presence in the apparel industry. However, Sara Lee, a frozen and prepackaged foods company, pursued a new industry when it bought Hanes—a manufacturer of hosiery and clothing.

A **diversified corporation** also called a **conglomerate** owns businesses that are unrelated to each other. Take the case of Honda. It is an auto manufacturer—all its different models of cars and trucks

and manufacturing plants and international markets don't change that. But it also manufactures motorcycles, power equipment (generators, lawnmowers, pumps, snowblowers, tillers, and trimmers), marine engines, and jet engines (HondaJet)—all different businesses (Honda.com, n.d.).



Yoshikazu Tsuno/AFP/Getty Images

An excellent example of an international diversified corporation is Disney, who has diversified in the entertainment industry by producing movies, TV broadcasting, theme parks, cruise lines, and stores all around the world.

So it is a multibusiness company. But is it diversified? No. All of its businesses have a common element—in fact its core competence—and that is engines and engine design. It doesn't produce anything that doesn't have an engine in it.

Consider another example. Disney Corp. is broadly in the entertainment industry, and is in animated and live moviemaking (and DVDs), TV broadcasting (ABC, ESPN, Disney Channel), theme parks (Walt Disney World and Disneyland and other resorts worldwide), cruise lines, licensing its trademarked characters to other companies, and its own stores that sell everything Disney, including books, toys, and branded merchandise (Disney, n.d.). Yes, it's a multibusiness corporation, but is it

diversified? To answer this question, use the definition as a guide, notwithstanding they are all in the "entertainment" industry. You will find that they are basically unrelated businesses—they have different competitors, demand different strategies and financial investments, and need different people to run them. Multibusiness corporations can encompass businesses that are related but still SBUs, like Wrigley's chewing gum and its acquisition of Lifesavers and Altoids from Kraft Foods. Related SBUs can benefit from shared expertise and resources and thus have high potential to add more value to the corporation. Multibusiness corporations can also own different companies that constitute a complete value chain, like the global, 100% vertically integrated oil companies that find and drill for oil, transport it via pipeline or tanker to their refineries, refine the crude into many different products, and sell some of those products directly to consumers (for example, gas and home heating oil).

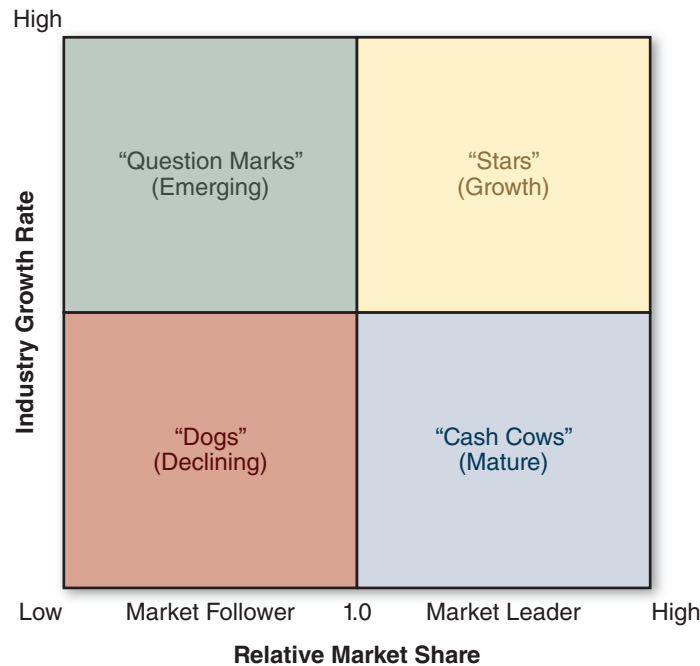
Management Challenges

Managing a corporation with multiple businesses involves everything we have discussed so far and more. Certainly, each business should be managed strategically and do strategic planning. One major difference is that these divisions or subsidiaries cannot go outside the corporation for financing, either to get a bank loan or any equity investment; they must ask the (parent) corporation for the financing they need. It is the parent that must make sure it has sufficient financial resources for the needs of all its companies.

As we know, companies at different stages of their lifecycle vary in their need for capital. Young growing and expanding companies are voracious in their appetite for funds, while those that are

mature and doing well are throwing off cash but still need funds for innovation. Knowing this about a corporation's businesses helps it to anticipate funding needs and preempts it from treating all its companies the same way. A useful way of arraying a corporation's portfolio of companies and their financial needs was created by the Boston Consulting Group (BCG) (Figure 11.1).

Figure 11.1: BCG portfolio matrix



Source: Adapted from Alan J. Rowe, Richard O. Mason, Karl E. Dickel, Richard B. Mann, and Robert J. Mockler, *Strategic Management: A Methodological Approach*, Fourth Edition (Reading, MA: Addison-Wesley Publishing Company, 1994) 253. Reprinted by permission of Pearson Education.

The matrix is used to array both a portfolio of products as well as a portfolio of companies. In the latter case, the "industry-growth-rate" axis applies to different industries. Both products and companies begin life as "question marks," a capital-intensive state, ideally growing in market share until they are the market leaders (relative market share 1.0) and become "stars." Over time, as the industry matures and they still retain market leadership, they become "cash cows," throwing off cash that is often used to fund new "question marks." The last quadrant, "dogs," although a nickname given by the Boston Group, is a misnomer. For example, in any mature industry, only one company can be market leader; does that make all the other companies "dogs"? Is Ford Motor Company, currently in number-two position in the automobile industry, a "dog"? While it is entirely possible for products and companies to go from "question marks" to "dogs" and still be profitable, BCG is really saying that companies should aim for and nurture "stars" and "cash cows."

The value for a multibusiness corporation is to use the tool to help manage the portfolio. A portfolio with too many "question marks" is going to require huge amounts of cash; however, with several cash cows to finance those needs, the overall pressure to raise capital is reduced. Also, a portfolio heavy with cash cows has no future stars on the horizon, jeopardizing the company's long-term future. So the need is to have a balanced portfolio.

There are four principal management challenges: (a) ensuring that the right person is heading up each company, (b) ensuring that each company is following the right strategy to perform to expectations, (c) getting as balanced a portfolio of companies as possible, and (d) maximizing the

synergy or advantages (also called “spillover effects”) created through related businesses (Saloner, Shepard, & Podolny, 2001). Even though the parent may have acquired a company with a CEO already at the helm, once the parent owns it, this becomes the parent company’s responsibility. Both company performance and reports from other senior and middle managers can provide a better indication. And the only way to check on the appropriateness of the strategy is to insist the company engages in strategic planning, read its strategic plan, and then grill the CEO and the key executives on its contents. If the answers are satisfactory, the parent company need only give them the capital they need, get out of the way, and let them perform. If the answers are not satisfactory, then there is a problem and management will have to work through to a new solution.

The kinds of questions to ask should be familiar by now:

- Is your current strategy working? Why or why not?
- How are your industry, competitors, markets, and technologies changing?
- How are these changes impacting the company? How are you planning to cope with these impacts?
- Do you have a competitive advantage? If not, are you trying to develop one?
- Do you have any financial problems, and, if so, how are you fixing them?
- What are the key strategic issues facing your company?
- What other strategic options did you consider? Why did you reject them?
- What makes you believe your strategy will work?
- What will you need (\$ amount) to implement your strategy?
- What could go wrong as you move ahead, and how might you cope with that?

Strategic-Management Complexities

Assuming that the SBU companies in a diversified corporation’s portfolio do the kind of strategic planning described in this book, what does the corporation’s top management do? It cannot do strategic planning because the companies in its portfolio are in different industries. Instead, it can do two things:

- Set corporate-wide annual objectives that are typically financial and profit-related, such as 15% ROE or 10% NPM.
- Sell any company in its portfolio that is preventing the corporation from achieving its objectives and buy any other that is a high performer to boost achievement of the corporation’s objectives. The strategic challenge becomes having the right portfolio and the portfolio’s ability to achieve the required financial performance.



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The track record of diversified corporations is dismal. Often, only corporate lawyers, investment bankers, and original sellers make a profit, rather than the shareholders.

As discussed earlier, a diversified corporation's first approach should be to "rescue" a poorly performing SBU, or give it a chance to right itself through following a different strategy, or even being led by a different CEO. Only if its performance cannot be improved quickly enough should the SBU be put up for sale. For example, conglomerate Sara Lee spun off Coach, a leading brand in leather goods in 2000, and sold its personal care products unit to Procter and Gamble, Unilever, and SC Johnson between 2009 and 2011 (Crown, 2006).

It is worth noting that the track record of diversified corporations or conglomerates in adding value has been historically dismal, just as the track record of acquisitions being successful (around 20%) is also dismal. Michael Porter, as far back as the late '80s, asserted that in the 33 companies he studied, only the lawyers, investment bankers, and original sellers profited from the diversification acquisitions, not the shareholders (Porter, 1987). One factor against a conglomerate's ability to add value is that each acquisition is unrelated, and few synergies or economies of scale are possible. Given this record, why do firms diversify, especially into unrelated businesses? One answer could be that it provides additional benefits to top-level executives that stockholders do not enjoy. As firms get larger, so does executive compensation. As firms become more complex and difficult to manage, so does executive compensation increase (Hitt, Ireland, & Hoskisson, 2007). And these correlations are true whether or not each new acquisition adds value to the firm.

Diversified firms with related businesses, either producing different products for the same consumer market nationally or internationally (like Kraft or Nestlé) or using proprietary technologies in all its products (like Canon), have a more difficult challenge in trying to maximize synergies and efficiencies among its portfolio companies. When they succeed, they perform beyond expectations; when they don't, the situation is harder to correct because of the web of relationships between and among the companies. The parent can't just "sell off" the underperforming unit. Diversified firms are often also international in scope, to which we turn in the next section.

Discussion Questions

1. Managing a diversified corporation at some point becomes largely a financial exercise—the overall objectives for the corporation are financial, and the decision to buy or sell companies for the portfolio is financial. Do you agree with this view? Why or why not?
2. If one of the portfolio companies in a diversified corporation wasn't performing up to expectations yet provided a valuable service to society and had first-rate people among its staff, what argument would you use to keep the company in the portfolio and get it to perform better?
3. What other kinds of expertise does a multibusiness corporation need at the top besides accounting and financial? Explain.
4. On what basis might staff at the corporate level be hired and fired?
5. Before acquiring a company to add to the portfolio, how might the management team really evaluate the company, which is in another industry, besides its financial results?

11.2 International Corporations

Companies, regardless of the country in which they ordinarily do business, are driven to go explore international opportunities for two principal reasons. One is the maturing of the home market and a subsequent slowing of its growth rate. The other is recognition of significant growth

opportunities for the company's product or service in one or more foreign countries. Either or both will impel a company to expand internationally.

Becoming an international corporation is not that simple. The biggest difference is that competing abroad is quite unlike competing at home in the United States. In each country, the rules and culture are different, the playing field is not level, competitors are ruthless, and prices demand that costs be lower than low. For example, in an analysis of the luxury fashion industry in Brazil, which has historically had a strong market for high-end fashion and accessories, Imran Amed (2012) wrote, "When you try to do business here, you will eventually find yourself stuck in a morass of government bureaucracy, corruption, and an incomprehensible system of taxation."

Stephen Rhinesmith underscores the complexity of a global organization; managers need to balance issues of "centralization vs. decentralization, global efficiency vs. local responsiveness, and geographic vs. functional priorities" (Rhinesmith, 1996, p. xii). Our focus at this point is on international, not global, corporations (which are discussed Section 11.3). **International corporations** include essentially domestic companies that export products to other countries through in-country representatives or distributors (requiring no knowledge of foreign markets), international corporations that have an international division with foreign subsidiaries or divisions, and multinational enterprises that establish mini-replicas of their domestic business in each foreign market, having foreign nationals manage those businesses. Nestlé of Switzerland is a good example of this last type. In fact, multinational corporations try to look like "multidomestic" organizations so that local regulatory authorities treat them as a local business.

Going International

In the arena of international business, the adage "know before you go" is important advice. Many countries in the world have consulate offices in the largest U.S. cities on both coasts, and they



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For companies venturing into the foreign market, there are management challenges involved in estimating the demand for a product.

are well informed as to what kinds of products are most needed in their countries as well as a list of products they are trying to export to the United States. They will also provide advice on how to go about exporting products to their country.

A prospective exporter must become familiar with the laws in that particular country, particularly as they apply to sell products there, pay taxes, and repatriate profits back to the home country. Japan, for example, is a closed market, and entering it requires a strategic alliance or partnership with a Japanese company. But the overarching consideration, besides potential demand, is the country's political climate and stability.

It is incumbent on any company planning to do business abroad to get all the information it can about the countries before deciding to expand elsewhere. Read voraciously about them and their relationships with the United States. Generate a list of questions and then seek answers from appropriate agencies of the federal government like the U.S. State Department. Best of all, visit the countries in question, shop at the kind of retail outlets that will stock your product, chat with customers, make appointments to talk with prospective business customers and distributors, and get information on bidding for government contracts if that is your market (of course, go with a translator if you cannot speak the language). Doing anything less heightens the risk immeasurably.

Management Challenges

For a company that has never ventured abroad before, there are considerable management challenges involved in doing so. In some respects, these challenges are similar to those that startups face when they enter a market for the first time. The most common include the following:

- Estimating demand for its product in that country (and in every country being considered for expansion). Obtaining data is vital; guesses or opinion are not the bases on which to make large financial decisions.
- Knowing the current competitors, some of whom could be familiar because they probably compete in the domestic market. And what prices and versions of the product are being sold, and why might the company's also fare well?
- Determining whether enough infrastructure is in place such as for transportation and telecommunications. This can be a major issue in developing countries.
- The dominant language spoken in that country and, if not English, how you will overcome that barrier.
- How long it will take to break even and make money. This involves knowing which international strategy (discussed in the following section) makes most sense, particularly in the beginning.
- Whether to hire staff in the foreign country and, if so, how to train them, reward them, and nurture loyalty in them.

Note again that domestic companies that outsource production or other services to another country are not considered international companies if they serve only their domestic market. However, Chinese factories, on the other hand, are international companies because most of their markets are in other countries (Midler, 2009). While companies that license their technology or trademarks to foreign companies are considered international in this discussion because their customers are located in other countries, the negotiations nevertheless take place on their home turf, and they don't have to learn about foreign cultures or business practices, or even take the risks that international companies do.

International Strategies

The following discussion includes different strategies that a hitherto domestic company can use to transform itself into an international company. They can be market-entry strategies as well as strategies to further its growth depending on available resources and what it might be facing competitively. They are discussed in order of increasing complexity, commitment, and cost.

Exporting and Market Expansion

Exporting doesn't require a presence in the host country, just knowledge of shipping and freight, insurance, and custom regulations. Most of all, it needs a distributor or importer in the host country that acts as the customer and places the orders. In an ideal situation, the importer would contact the company (manufacturer) to make the deal, but more typically, the company has to find the customer. With foreign consulates in the home country and the power of the Internet and telephone, the problem is not insurmountable. However, the domestic company will discover a great deal of pressure on prices, because it is now competing with manufacturers from all over the world.

To a large extent, how a company responds to pricing pressure depends on the country that is receiving the goods. The European Union is very different from a developing country like India. Savvy U.S. manufacturers, unless their product is unique and proprietary, might arrange to outsource manufacturing to reduce the price and then have the product shipped directly to their foreign customers, saving even more money. Of course, that introduces additional risks. There is the danger that the outsourced manufacturer has no scruples about selling the product to still other customers in other countries (Midler, 2009).



AP Images/James Crisp

Toyota built car-manufacturing plants in the United States when they determined it was more profitable to build and sell cars in the United States rather than ship them from Japan.

A risk that cannot be avoided (except by choosing a different foreign market) is currency-exchange fluctuations. For example, a surge of the Japanese yen against the U.S. dollar recently erased 80 billion yen (\$1 billion) from Toyota's latest (2011 Q3) quarterly net income (Associated Press, 2011, Toyota profit drops). When a company determines that too much money is being lost bringing profits home, it will try to establish a manufacturing plant in the host country. That not only reduces currency-exchange losses, but also transportation costs and pressure on the home factory to produce for both markets. Keeping with the example of the auto industry, there is another benefit to a manufacturer that decides to open a plant in different state or city. An assembly plant has a tremendous impact on a community in numerous ways, not only in terms of lowering employment but also through an economic multiplier effect. Bringing a major automobile-assembly plant to a community represents a coup to the immediate community and also to a broad region that can even include bordering states. With high average wages and a job-creation multiplier of 7.5—the highest of any industry in the United States—and capital investment that can potentially reach \$1 billion or more (McAlinden & Fulton, 2001), it is easy to see why communities battle each other to be chosen for an automotive-assembly plant. The cost to attract such an automotive investment is high; in some cases communities have offered incentive packages to car manufacturers reaching upward of \$300 million per facility and over \$100,000 per job (Car Research, 2003).

Market expansion, unlike exporting, does require a presence in the foreign market. Market expansion is a way of ending dependence on a foreign distributor or importer, which doesn't release any market information, and eliminating the markup it charges. Companies open sales offices and staff

them with nationals of that country, because it's easier to train a local person about the product and company's procedures than to transplant someone from the home market and expect them to learn about the country, its culture, business practices, and market. Kenichi Ohmae (1990) believes the problem is more complex than this. Companies are held back because they cannot seem to get rid of the "headquarters" mentality. This is not just a problem of bad attitude, but rather stems from their entrenched systems, structures, and behaviors. But these are the last to get management's attention because the first symptoms are local (in the host country). For example, if advertising in the host country is not paying off as expected, the company may not recognize that the cause could be back at its own headquarters. Lacking cultural awareness, it may not understand what it takes to market effectively in the host country. Other possible causes for the failure to realize anticipated results include a reluctance to make long-term, front-end capital investments in new markets, or a failure to perform well in the central job of any headquarters operation—the development of good people at the local level. Instead the failure may be diagnosed as a local problem and the company will try to "fix" that (Ohmae, 1990).

One of the challenges is the tension between headquarters telling the host sales office what to do, and the sales office—because of its proximity to the customer and knowledge of market trends in that country—telling headquarters what should be done. There is no easy solution to the problem except to choose the host sales manager with care; it should be someone headquarters can really trust and listen to. Headquarters should remind itself why it hired that person and what it is trying to do in that market, and be open to suggestions that can benefit both. If things turn out as planned, the host sales office will grow to become a major part of the international division of the home company, a pattern to be repeated with every new foreign market the company chooses to enter.

Another challenge is the realization that different countries require different versions or variations of the product. An example would be Europeans needing very small major appliances, like clothes washers and dryers and dishwashers, because they more commonly live in small apartments, unlike the very large appliances common in more spacious U.S. homes. Such product changes grow out of market research—the data and intelligence collected and made sense of by the office that the company maintains in that country. This typifies a **multidomestic strategy**, when cus-

tomer demands and needs vary substantially from country to country, forcing a company to modify any combination of product features, packaging, advertising, service-delivery methods, and pricing; centralized control or integration is virtually impossible (Abraham, 2006). For example, McDonald's has succeeded in France, in part, by demonstrating an understanding of the country's cultural preference for longer, more leisurely meals than U.S. customers prefer and offering table service in response. Further, because the French are not inclined to "snack" in between meals, McDonald's emphasizes meals rather than the quick-serve



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Eighty percent of Coca-Cola Company's revenues are outside the United States, making it perhaps the biggest global franchise in the world.

snack foods that are so popular in the United States. And, the company has introduced cultural favorites to the French McDonald's menu—such as baguettes (Fancourt, Lewis & Majka, 2012).

Another international-market-expansion strategy is **franchising**, which has been used successfully by well-known companies in the fast-food industry like McDonald's, KFC, and Subway (Hitt, Ireland, & Hoskisson, 2007). However, a host country's culture and preferences may dictate modifications in the menu items. For example, McDonald's in India could not serve beef because the cow is a sacred animal to Indians and Hindus; it served vegetarian and mutton burgers instead. Subway, when it first entered China, found the going difficult because the Chinese weren't used to eating with their hands; so at least one item on the menu had to be eaten with chopsticks (Hitt, Ireland, & Hoskisson, 2007).

Perhaps the most global franchise system is Coca-Cola, which derives over 80% of its revenues outside the United States. It franchises bottlers in virtually every country in the world; to manage those companies, it depends on the relationship with its bottlers and thus has to be organized geographically. For example, the Eurasian and Africa Group is responsible for 90 emerging markets, headquartered in Turkey (Holstein, 2011). Franchising is also the way in which the product turns out to be identical no matter the location.

Strategic Alliances

Forming strategic alliances has become more popular over time principally because it allows firms to share both risks and resources as it tries to enter international markets. (Strategic alliances were introduced in Section 1.6. This section discusses the role of strategic alliances only in international expansion, sometimes called cross-border strategic alliances.) If the right partner can be found, then a strategic alliance with a firm in the host country has distinct advantages over a simple exporting or market-expansion strategy:

- The host partner is familiar with the host market, industry and competitive conditions, legal and social norms, political trends, and cultural idiosyncrasies of the country.
- Partnering with a local host company avoids paying tariffs and is sometimes the only way a foreign company can do business in a host country. This is true of Japan, which is otherwise closed to foreign businesses.
- The risks (and profits) are shared.
- Both partners learn capabilities from the other, including but not limited to technological skills, competitive/marketing skills, and a greater cultural awareness. (By the same token, each partner brings to the relationship unique knowledge and resources.)

While many strategic alliances are formed to create a competitive advantage, the purpose in this context is to expand the market for the home company in a way that reduces the risk and raises the probability of success (Ireland, Hitt, & Valdyanath, 2002). A successful strategic alliance depends critically on doing due diligence on the prospective partner and developing a sound agreement to which both parties are committed. Many companies have expanded their markets in this way, including Fujitsu, Cisco, Dell, and Microsoft. Lockheed Martin has formed over 250 alliances with firms in more than 30 countries (Hitt, Ireland, & Hoskisson, 2007). French automaker Renault has had a successful strategic alliance over the years with Japanese automaker Nissan because it was well managed; executives from both companies knew their companies well, understood how each partner perceived the other, and could adapt while remaining true to their own company and cultural values (Pooley, 2005). The primary reasons why strategic alliances fail include incompatible

partners, often a result of rushing into the agreement without fully considering key factors, and conflict between the partners (Robins, Tallman, & Fladmoe-Lindqvist, 2002). In addition, the very nature of cross-cultural alliances can complicate the negotiation process and result in a lack of communication and trust between the partners. Other reasons for failure include the possibility that one partner acts opportunistically outside the terms of the agreement, a lack of trust (which cannot be overemphasized), “stealing” proprietary information and even the partner’s tacit knowledge of processes and ways of doing business, misrepresenting resources and competences brought to the relationship, and a lack of transparency regarding necessary disclosures (Midler, 2009).

In pursuing international expansion, host-country partners are typically distributors. Some refer to this as a vertical complementary strategic alliance because it shares resources and capabilities from different stages of the value chain (as in vertical integration), compared to a horizontal complementary strategic alliance that involves one with a competitor. Choosing the right distributor partner is not easy. It has to have a good reputation with retailers (or with companies if the market is commercial) and the physical and organizational capacity to grow. A different kind of alliance would be with a manufacturer in the host country, not a distributor, and would entail a **cross-distribution alliance**, which is an agreement between two companies in different countries to market and distribute each other’s products in the other’s country. If this possibility is appealing, then the search for a partner should include manufacturers of products that are targeting similar markets and would benefit from this particular kind of strategic alliance.

Joint Ventures

A **joint venture** is a strategic alliance that requires a greater level of commitment. Also governed by an agreement between the two parties, a joint venture requires the formation of a separate corporate entity jointly owned by the two parties. International joint ventures are particularly difficult to manage successfully for some of the same reasons that complicate strategic alliances. Care should be taken in choosing the country in the first place before looking for potential joint venture partners; for example, Russia appears to have significant disadvantages that should be taken into account, including a chronic shortage of certain raw materials and difficulty repatriating profits back to the home country, which neither Russian banks nor authorities can guarantee or facilitate. A company contemplating this type of arrangement must also take measures to protect against government expropriation such as by limiting the circumstances in which it would be considered legal, defining a lump sum in U.S. dollars should expropriation occur unexpectedly, and taking out expropriation insurance before signing an agreement. American companies must also address natural-environmental issues, because Westerners often are blamed for air- and water-pollution problems and habitat destruction (David, 2005).



AP Images/Imaginechina

Starbucks and President’s Coffee of China formed a joint venture to open hundreds of Starbucks stores in China, creating a whole new market for what had previously been a nation of tea drinkers.

The following are examples of well-known joint ventures:

- NUMMI (New United Motor Manufacturing, Inc.), the joint venture between General Motors and Toyota formed in 1984 in Fremont, California (and recently disbanded in 2010). GM saw an opportunity to learn about lean manufacturing, and Toyota established its first manufacturing base in North America and the chance to implement its production system in an American labor environment (Bensinger & Strack, 2009). NUMMI produced a number of models, notably the GM brands Geo Prizm and Pontiac Vibe and Toyota brands Voltz, Corolla, and Tacoma pickup truck. GM, despite its reason for entering into the joint venture, did not apply what it learned about efficient Japanese manufacturing to its other manufacturing divisions.
- Hewlett Packard's entry into the computer market in Japan through forming a joint venture with Yokogawa Electric (Yokogawa Electric, 1999).
- Starbucks formed a joint venture with China's President's Coffee to open hundreds of Starbucks coffeehouses in China. Long a country of tea drinkers, Starbucks is succeeding in helping the Chinese develop a taste for coffee (David, 2005).
- The Dutch company Philips Electronics NV has over \$2.5 billion worth of investment in China that includes 30 wholly owned enterprises and joint ventures that employ 18,000 people and produce everything from semiconductors and lighting to medical diagnostic imaging equipment (David, 2005).

Joint ventures can prove thorny if managers assigned to operate the venture were not involved in forming or shaping it, if customers experience poorer service, if the support from the two "parents" is unequal in important ways, or if the venture itself begins to compete with one of the parents (Hutheesing, 2001).

Acquisition

Cross-border acquisitions increased significantly during the 1990s and comprised 45% of all acquisitions completed worldwide (Shimizu, Hitt, Valdyanath, & Pisano, 2004). Why should a company expand internationally by acquiring another when it could form a strategic alliance or even a joint venture? There are several reasons for preferring an acquisition strategy:

- Where the business is the same, it enhances economies of scale.
- In cases where technology transfer takes place, proprietary processes and other intellectual property can be more easily safeguarded.
- It provides the fastest and often largest initial international expansion of any of the other international strategies (Hitt & Pisano, 2003). Walmart expanded into Germany and the UK through acquiring local firms (Levine, 2004). In most cases, the buildings and locations already exist instead of having to be built and situated, which takes considerable time in any country.
- While similar to a strategic-alliance strategy, in that the home company has partners in the host country to continue the expansion, only in the case of an acquisition can the acquirer control what the acquired company does.
- It lends itself to replication if the acquiring firm has become adept at acquiring companies (foreign or domestic), that is to say, develops a core competence in doing this. The large companies that rely on acquisitions to grow have departments with experienced people whose sole job is to help make and help digest each acquisition.

Many references and mentions about acquisitions frequently include mergers and confuse the two, but, as Section 1.6 makes clear, the strategies are very different. As an international expansion strategy, mergers are far less common and more difficult to pull off, primarily because cultures from different countries must be successfully integrated.

Acquiring companies must realize that negotiations to acquire a company in another country are more complex than those for a domestic acquisition and must deal with two legal systems; only about 20% of cross-border bids lead to a completed acquisition compared to 40% of bids for domestic acquisitions (French dressing, 1999).

Ethics Challenges

Companies doing business in the international arena often find themselves facing ethical dilemmas. What is regarded as “unethical” at home sometimes seems to be “business as usual” in other countries. As the saying goes, “When in Rome, do as the Romans do.” If other companies are doing it and, in U.S. eyes, are “getting away with it,” why not do likewise?



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The U.S. Securities and Exchange Commission enforces the international accounting provisions through the 1977 Foreign Corrupt Practices Act.

The Foreign Corrupt Practices Act is a federal law enacted in 1977 to prohibit companies from paying bribes to foreign government officials and political figures for the purpose of obtaining business. There are two provisions to the Act: anti-bribery provisions, enforced by the Department of Justice, and accounting provisions, enforced by the Securities and Exchange Commission (World Compliance, 2011). A U.S. company, for example, found to have been engaging in bribery abroad, taking or giving kickbacks in order to win a contract, can be prosecuted at home regardless of whether others engage in the practice. Enforcement of the regulation has increased dramatically in the past three years.

Other challenges, encountered principally in international marketing, include but are not limited to the following:

- Gifts/favors/entertainment—include a range of items such as lavish physical gifts, sex workers, opportunities for personal travel at the company’s expense, gifts received after the completion of a transaction, and other extravagant expensive entertainment.
- Pricing—includes unfair differential pricing, questionable invoicing (where the buyer requests a written invoice showing a price other than the actual price paid), pricing to force out local competition, dumping products at prices well below that in the home country, and pricing practices that are illegal in the United States but legal in the host country, like price-fixing agreements.

- Products/technology—includes products and technology that are banned for use in the home country but permitted in the host country and/or appear unsuitable or inappropriate for use by people in the host country.
- Tax-evasion practices—such as transfer pricing (where prices paid between affiliates and/or the parent company are adjusted to affect profit allocation) including the use of tax havens, where any profit made is registered in a low-tax jurisdiction, adjusted interest payments on intra-firm loans, and questionable management and service fees charged between affiliates and/or the parent company.
- Activities considered illegal or immoral in the host country—such as polluting the environment, maintaining unsafe working conditions, product/technology copying where protection of patents, trademarks, or copyrights are not enforced (this is of particular concern in China), and short-weighting overseas shipments so as to charge a country a phantom weight.
- Questionable commissions to channel members—unreasonably large commissions paid to channel members, such as sales agents, middlemen, consultants, dealers, and importers.
- Involvement in political affairs—related to the combination of marketing activities and politics including the exertion of political influence by multinationals, engaging in marketing activities when either home or host country is at war, and illegal technology transfers. (Armstrong, 1992)

In many instances the playing field is not level for an international firm, but that's why developing or acquiring skills traversing that field is a decided advantage.

Discussion Questions

1. How does environmental analysis differ in the international arena from the home market? Comment on the relative difficulty of obtaining the requisite information.
2. Choosing an international strategy is often difficult—is it better to open a sales office, form a strategic alliance, or acquire a company in the target country? We know that country-specific factors and the potential size of the opportunity significantly affect the decision. But what role do financial considerations play? For example, how important is the size of the required investment, return on that investment (including ease of repatriating full profits), and time to breakeven (to recoup the investment)? Should these be more or less important? Explain.
3. Which kinds of international strategies are most appropriate for companies in the following domestic industries to use, and why?
 - producing movies
 - software
 - management consulting
 - breakfast cereals
 - school of business
4. Imagine playing a role in deciding an international strategy for a company. You decide that forming a strategic alliance with a company in Brazil is the best way to go to enter that market. But negotiations don't go well because the deal is not structured fairly and you distrust the potential partner. Do you keep looking for the right partner or decide on another strategy?
5. When competing and operating internationally, by which moral compass do you steer? To what extent are your actions governed by what you perceive to be ethical and right? Discuss.

11.3 Global Corporations

Global corporations are designed to compete globally and serve markets in most countries of the world that have enough experience and have developed sophisticated systems to manage such a complex enterprise. They are typically in one major industry (like electronics, telecommunications, or automobiles) but may have many product lines in many segments of that industry in order to achieve a global brand and economies in many areas of the value chain.

Global vs. International Corporations

There are two principal differences between global corporations and international corporations. The first is that a global company has centralized strategy-making and marketing control, meaning that country-specific product preferences are minimal or nonexistent, and a standardized product can be marketed and sold to all countries, generating significant economies of scale in purchasing, production, and advertising. SBUs operating in each country are interdependent and coordinated and integrated by the home office (MacMillan, Van Putten, & McGrath, 2003). The second difference is that global businesses have the freedom to move functions to anywhere in the world; for example, they can purchase from anywhere, produce anywhere, carry out R&D anywhere, acquire companies anywhere, and even move the headquarters anywhere in the world.

A good example is the Focus ST (Sports Technology), a car manufactured by the Ford Motor Co., which is a multinational corporation. This Focus was designed, manufactured, and marketed in several countries. It is now available in more than 40 markets including the United States, Canada, Mexico, South Africa, Australia, New Zealand, and 15 countries in Europe. The Ford Global Performance Vehicles group—a partnership between Europe's Team RS and North America's Special Vehicle Team (SVT)—is responsible for engineering it.

Focus ST has not come around by chance. . . . What came first was our global performance strategy, which has been developed with North America, Europe, and Asia together. With this, the core DNA attributes—steering, driving dynamics, sound quality, and power enhancements for all ST models—have been defined to the extent that our engineers can take that global DNA fingerprint and use it to create the new Focus ST. (Jost Capito, as quoted in Ford News Center, 2011)

Management Challenges

The discussion here presumes that most of the challenges that beset the various international strategies also apply to pursuing global strategies. In addition, the following should be mentioned:

- Customer needs may change over time resulting in diminished demand for the global product. If the corporation is attentive, then it should take steps to phase in a transnational strategy, a name for a global strategy that capitalizes on efficiencies and economies of scale while being locally responsive, epitomized by the familiar saying, “Think globally, act locally.”

Whirlpool Corporation embarked on a global strategy in the late 1980s, anticipating that a few global players would dominate the worldwide appliance industry. It grew through acquisitions and investments in companies in Europe, India, China, and South America. However, by the mid-90s, it suffered large losses in every market, calling into question its centralized global strategy. Once the company had established itself in these countries, each center of production began developing various skills and designs tailored



AP Images/Sakchai Lalit

Global strategies are vulnerable to local catastrophes that disrupt their operations. In October of 2011, flooding at a Honda plant in Thailand caused a chronic shortage of parts, forcing Honda to cut production by 50% in the United States and Canada.

to that particular region—they became centers of excellence for technology and production. In fact, the Whirlpool’s Duet washers and dryers now popular in the United States are engineered and made in Germany; the quality of its “kink-free German technology” justifies the high price and outsells the competition (Hitt, Ireland, & Hoskisson, 2007).

- Global strategies are particularly vulnerable to local catastrophes that disrupt finely tuned operations. Two recent examples involve Toyota and Honda. Toyota’s plung-

ing sales and profits in the summer of 2011 were caused by parts shortages from the combination earthquake and tsunami disaster in northeastern Japan in March 2011 that closed its factory for a month (Associated Press, 2011, Toyota profit drops). Honda likewise suffered from a sudden parts shortage when three months of catastrophic flooding in Thailand forced Honda to cut U.S. and Canadian factory production by 50% for the second time in a year. The cuts came just as Honda was recovering from the March 11 earthquake and tsunami in Japan (Associated Press, 2011, Honda to cut).

Global corporations often use sophisticated modeling and analysis techniques, perhaps more than multinational corporations. They use variants of the “traveling salesman problem,” which chooses an optimum route for a sales representative to visit a number of cities at least once and travel the least distance. Global corporations use approximations of the model to locate factories and assembly plants to be both close to suppliers and close to customers in order to minimize transportation costs. Such a model can at best be a guide, however, because other factors must be taken into account such as investments, laws, and labor pool in particular countries that cannot be included in a quantitative model. The insights gained from such analyses enable the corporation to derive new solutions as soon as conditions change, just as a PERT model can be reconfigured instantly to recompute a new critical path to take into account delays or overspending in completing previous tasks.

Discussion Questions

1. Why do you think only a few companies achieve a bona fide globalization strategy?
2. Can you think of any forces that might be acting against globalization?
3. Research assignment: Go to the following companies’ websites and determine whether they are pursuing a global, transnational, or multinational strategy (justify your conclusions):

• IKEA	• Siemens
• Sony	• Singapore Airlines
• BMW	• Netflix
• Cisco	• Google
• Exxon	• Walmart
4. Can you come up with any social or political arguments against globalization?
5. Can a global corporation become too big? Why or why not?

11.4 Startups and Small Businesses

Having considered the case of very large multinational and global companies, we now turn our attention to very small businesses. While many startups and small businesses have little or no history, have insufficient funds at their disposal, and don't do strategic management or strategic planning, only startups need a business plan, not a strategic plan. A **startup** is a company, venture, or organization that comes into being the moment money is expended in its behalf, not when revenues are achieved or when it is registered. This section discusses startups first and then covers small businesses, which need to do strategic planning and management, but usually don't. Defining **small business** is a matter of opinion as there is no standard agreement as to how small is small. On the grand scale of things, while companies with revenues or sales of under \$100 million qualify as "small," this section focuses on even smaller businesses that have sales of under \$10 million.



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Startups need a business plan to help secure needed funding to launch new products, as well as an operational plan to guide them to their objective.

Business Plans vs. Strategic Plans

Startups have no way of answering the following questions:

- Is the current strategy working?
- Should the current strategy be changed?
- Does the company have any financial problems?
- What strategic options does the company have?

These questions are at the heart of strategic planning and require both some history to go on and the existence of strategic options to consider. Startups have neither.

Instead, startups are formed and come into being with a product or service idea of sufficient merit to enable them to enter the industry and immediately be competitive. The startup's industry is preordained by its particular product or service or, in extremely rare cases, by creating a brand-new industry. Its strategy is to enter the market, which it does usually through innovation and differentiation strategies, but sometimes through cost leadership (as when a startup disrupts incumbents in an industry with a much lower price point).

What startups need is a business plan, for two reasons—to secure funding the company needs to launch its product or service and to develop an operating plan to guide what it needs to do. With respect to securing investors, a business plan is a document that clearly explains the concept of

the business, the opportunity it is going after, its vision in the five-to-seven year range, how it intends to meet existing competition, how it will make and price the product, why there will be a demand for it, when the company will break even, how much startup capital is sought and how it will be spent, and the founder's experience, motivation, and how much of his or her own money is invested in the company.

A business plan for operational purposes needs only to have a detailed cash-flow projection for two years by month with lots of detail, notably the sales projections form revenue targets for each month and the expenses form monthly budgets. Once things get going, the plan needs constant updating to reflect new realities. It is for this reason that some people say that it isn't worth putting together a startup business plan, because no sooner has the ink dried than everything has changed.

Securing funding is often a huge problem; it is the rare startup (other than a mom-and-pop) that can launch a business financed entirely by the owner. Even getting a bank loan is problematic because banks typically require three years of profitable operations before giving a loan without commensurate collateral. In the economic climate following the banking crisis of 2008, many lenders raised their lending requirements or stopped making small-business loans entirely. But they continued to give a loan on the basis of collateral or with a cosigner whose credit rating and net worth were sufficient.

Business plans constitute the principal way that startups secure external equity funding, typically from venture capitalists and angel investors. Getting the right investors that are as motivated for the venture to succeed as they are to make money is not easy. What many entrepreneurs don't realize is that venture capitalists are as eager to find a good venture that has some likelihood of succeeding as entrepreneurs are to get funded.

Outline of a Business Plan

Executive Summary (This should be done last and summarize every section in the business plan; its purpose is to get an investor to read the plan. It precedes the table of contents, is not page-numbered, and should be one page long single-spaced.)

Main Sections

The Business Concept (one page)—introduce the company or idea, tell how the company came to be, describe its history to date if it has already been started (this may take up to three pages), and provide contact information (person to contact, address, phone, e-mail, website).

Industry and Competitive Analysis (what you know about the industry in which you will compete and your competitors).

Market Analysis (everything you know about your customers—how many, whether growing, where dispersed, how they buy, price-sensitivity, needs, trends—consumer or business customers).

Environmental Trends (in the economy, technology, regulation, sociocultural, political, etc.—what might adversely affect the startup?)

Management Team (include ownership, who is taking what management role, how the company is organized now and at the end of two years, and something about the values or culture and how these will be sustained. Principal roles are marketing, operations, finance, and R&D/engineering for a technical product).

Marketing Plan (what activities are needed to get the intended sales and how much will they cost).

Operations Plan (include all other programs, such as training, IT, staffing, leasing, manufacturing, outsourcing, security, etc. not included in the marketing or financial plans).

R&D/Engineering Plan (include if the company is still developing its product or intends to develop a next-generation product).

Financial Projections and Investment Deal (must include two years of projections, by month, with subtotals for each year, both for a “most likely” scenario and a “worst-case” scenario; must include a section called “Assumptions” that explains every number in the projections, together with a summary of the differences between the most-likely and worst-case projections [typically 4–6 key differences]; must summarize the key results from the projections, e.g., revenues and cash surplus [loss] for each year, return on initial investment, breakeven month, and capital investment required; and if outside investment is required, then must include a section on the investment deal [not a loan, because startups can’t really get loans save in exceptional circumstances or from a family member]—amount required, stock percentage offered, how proceeds will be used, and any other terms).

Risks and Contingencies (enumerate the major risks the startup will face and what will be done to cope with or ameliorate each one).

Appendices (these can be A, B, C, etc. if you have more than one; continue with the page numbering. Full résumés of all principles should be in one appendix.)

Source: Adapted from Stanley C. Abraham, handout for his course on The Business Plan, California Polytechnic University, 2011.

A **venture capitalist** is a person that invests in a startup or expanding business venture with potential to achieve significant returns on invested capital. Venture capitalists are looking for a high rate of return, to compensate for the much higher risk involved in investing in early-stage startups. Typically they are looking for over 25% but often closer to 40% return. When a high-tech prototype, for example, has proven the business concept and production begins, much of the early risk has dissipated and returns are much lower.



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What’s the difference between a venture capitalist and an angel investor? An **angel investor** is a former entrepreneur that has become wealthy from prior ventures and wants to help other entrepreneurs,

One of the most important challenges for a startup business is keeping it properly capitalized.

usually in the same field. For example, someone that founded and sold a software venture is inclined to invest only in software startups. Angel investors typically invest smaller amounts than venture capitalists and take a more active role with the company's management. It is not uncommon for ventures to be funded by a group of angel investors, just as very large ventures expanding nationally (like IKEA) would be funded by several venture-capital firms and other investors.

An oft-overlooked source of funding, particularly with high-tech companies that have developed new technology, is a strategic alliance with a large corporation. Such corporations, both domestic and foreign and in many different industries, invest in entrepreneurial companies in return for rights to make or market new products and services. The investment is considerable for the small company and, besides the aforementioned rights, might also involve a small ownership stake (Silver, 1993).

Unique Challenges Facing Startups

The biggest challenge, of course, is to produce the product successfully, establish it, get people buying it, generate positive cash flow, and continue to grow—easy to say but very hard to do. To accomplish this, other challenges need to be met almost simultaneously:

- Make sure the company continues to be properly capitalized as it grows and expands, yet not relinquish too much of the founders' shares in the process. High-tech startups should consider forming a strategic alliance with a large corporation interested in its technology in exchange for the capital it needs and first rights to using the technology.
- Make sure the right people are hired who can do the job and perpetuate the culture of the founders.
- Be extra careful in forming a partnership; the partner might look perfect in the beginning, but it's not until the contracts have been signed and the working relationship is tested that the viability of the relationship becomes apparent. Also, choose partners with complementary skills and experience (not a clone of you) and a history that will not prove detrimental to the company (Jaffe, 1998).
- Adjust quickly as more is learned about the company's customers and competitors; while the business plan is a good foundation to start the business and obtain initial capital, it quickly becomes out of date.

These challenges are all business-related. However, many new entrepreneurs with ideas worth investing in have virtually no business experience. Depending upon the industry, they may be software or IT experts, scientists of one kind or another, or engineers that know more than anyone else about their product and why it works and, as a consequence, have a product-centered view of the business. The problem with this is that such an entrepreneur may tend to dwell on the technical aspects of the product, where they feel most comfortable, forgetting that venture capitalists are not necessarily technically inclined and are more interested in the business aspect of the startup. It is important when seeking funding to develop a customer-centered view of the business and speak the language of venture capitalists. There's nothing wrong with being the best expert in the world on the technology or product, but a startup needs to have someone on the team who knows marketing, accounting, and finance.

Strategic Planning Challenges for Small Businesses

A **small business** is one that is privately owned and operated, having a small number of employees and relatively low volume of sales. Small businesses are normally privately owned corporations, partnerships, or sole proprietorships. The legal definition of “small” varies from a sole proprietor to under 500 employees, which is the limit to qualify for many Small Business Administration programs. Small businesses can also be classified according to sales, assets, or net profits. This discussion excludes startups that have the benefit of carefully conceived business plans and investor advisors and that are designed to grow quickly. It also excludes sole proprietorships, like CPAs and consultants, and independently owned mom-and-pop businesses, like convenience stores. Finally, it excludes franchisees that, although independently run, are too constrained by the corporate parent through its franchise agreement and, for the franchised business certainly, are restricted from doing strategic planning.

Very small businesses, below \$1 million in revenues, focus on surviving and, if they can, growing. They typically don’t have additional staff to do research, or information systems to provide them with performance data when they need it, and are so pressed for time by the exigencies of day-to-day demands they don’t often find time for strategic planning. Many small-business owners don’t know how to do strategic planning and often cannot afford a consultant to help them. Finally, they may not *need* to do strategic planning. They may be pursuing the same strategy they had when the company was founded, spending all their resources, time, and energy in making it work, getting established, and surviving amid the competition. If the strategy is not working, the company will go

under, usually by the owner declaring personal bankruptcy. It often has neither the know-how nor the resources to adopt a new strategy even if it knew what that might be.



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Small businesses that grow to a certain size begin doing strategic planning.

Small businesses in the \$1–10 million range also face the same challenges to do strategic planning but are probably organized better, have systems in place, and more experienced managers in leadership positions to help the owner. But they are still strapped for time and resources and may see no need to change the strategy if they are still growing. If the strategy faltered, the owner would seek either to be acquired or to declare bankruptcy.

However, if performance had

dropped far enough (or debt risen high enough) to adversely affect the price the company could get for selling it, then it might seek consulting assistance to explore other alternatives, like targeting a completely different market and restructuring its debt and cutting costs.

Larger small businesses, with revenues over \$10 million, are often more sophisticated and financially more able to do strategic planning. However, in many cases, it is more likely than not for the owner to dictate what the company should do strategically and get the other functional vice presidents to go along. Doing really participative, research-based strategic planning with a group of top executives and operational managers is still rare with companies of this size. They have grown successfully without doing it and, subconsciously, often feel they can continue in the same vein.

The Association for Strategic Planning (ASP), a nonprofit professional society whose mission is to help people and organizations to succeed through improved strategic thinking, planning, and action (Association for Strategic Planning, n.d.) has, since its inception, tried to appeal to small businesses. To date, however, small business owners and managers account for only about 1.5% of its current membership. The inference is that despite ASP's efforts and word-of-mouth advertising, small businesses don't have time to even learn more about strategic planning.

Strategic Management for Small Businesses

Some small businesses that reach a certain size do begin doing strategic planning, if only because they are not sure what the best course of action is in the foreseeable future. Perhaps also a recent executive hire with strategic-planning experience persuaded the owner/CEO that the benefits of doing it would outweigh the costs. Either way, there are obstacles that need to be overcome.

First, assuming that the company's new executive could organize and facilitate a strategic-planning process, it would have to be explained and justified to the other key managers in the company. There would need to be training: What is it? Why do it? How will things change? There would need to be preparation; specific people would be asked to compile more information on external changes and educate the group. Then the group might spend a weekend offsite for an open discussion about feasible options the company could consider and, under the circumstances, which one might be best. If an option other than the one the company was pursuing were chosen, then the discussion should tackle how it was going to implement it and how it might be funded.

Even doing bare-bones strategic planning is not easy, especially for managers that are not used to the process in which decisions are made based on their input. But the predominant benefit for doing strategic management is a greater level of confidence that the company is pursuing the right strategy to be able to compete more effectively and achieve its vision and objectives. Without going through strategic planning, the company wouldn't have paused to reflect on what it was doing and whether there was anything else it could be doing that would benefit it more. Other benefits, particularly for smaller businesses doing strategic planning for the first time, are updating everyone's mental models to reflect a common reality and realizing that change is inevitable—the best kind being that which you initiate, not that to which you have to react.

Discussion Questions

1. Startups and small businesses often don't do strategic planning, or they have an aversion toward it; yet, changes keep happening all around them all the time. How are they able to grow and survive without doing strategic planning?
2. What arguments would you use to persuade the owner/president of a small business that strategic planning would benefit his or her company, even if only one person participated?
3. Do venture capitalists and angel investors need to have a strategic-planning background in order to judge whether a business plan is real enough and has a good chance of succeeding? Discuss.
4. The success rate of venture-capital investments is only 20%. Do you believe the reason for this is unforeseen circumstances, a poor assessment of the entrepreneur, or a lack of experience (and strategic-planning knowledge) on the part of the venture capitalist? Explain your choice.
5. An entrepreneur has written a detailed business plan, probably with the help of a consultant. What advice would you give to prepare him or her for a meeting with investors that have read the business plan? How can the entrepreneur make the best impression?

11.5 Nonprofit Organizations

MBA programs, in general, don't have specific courses on managing nonprofit or not-for-profit organizations. Many feel this is a huge omission. Nonprofits or 501(c) tax-exempt organizations in the United States in 2009 numbered over 1.5 million, accounted for 9% of all wages and salaries paid in the United States, and comprised 5.4% of GDP (Urban Institute, n.d., a).

Nonprofits include arts organizations, some institutions of higher education, some hospitals, human-services organizations, religious organizations, foundations, museums, social-welfare, labor unions, neighborhood organizations, business leagues, and social and recreational clubs, among many other categories (Urban Institute, n.d., b). Only those organizations knowledgeable about strategic management manage strategically, and then with variable success. Numerous consulting firms specialize in strategic planning and organizational development for nonprofit organizations. For example, Raybin Associates specializes in fundraising, strategic planning, and management development for arts-related organizations and has completed projects for the New York Public Library, the Historic House Trust, and the Virginia Museum of Fine Arts (Raybin.com., n.d.).

How Nonprofits Differ from For-Profit Corporations

The key difference between **nonprofit organizations** and for-profit organizations is that their primary goal is not financial in nature, and this applies even to foundations, which must manage huge endowments. Yet all of them need money to exist and operate, and they must be managed. Being registered as a nonprofit means that the organization is a legal entity giving its members and officers the benefit of limited liability. Counterintuitively, so long as the organization does not benefit a single person and is organized for a nonprofit purpose, it *can* make a profit on which it is not taxed if it has also met the IRS test for tax-exempt status. It has to meet both state and federal requirements to operate as a tax-exempt organization (Allen, 2006).

Another difference is that the source of funding comes from a third party and not directly from those that benefit from the service—that is, a customer. Nonprofits must rely on reports of past progress and accomplishments and proposals for more funding. The feedback from “customers” that for-profits rely on to dictate what products to produce is missing for nonprofits. If the customer is whoever is supplying money to the entity, is the foundation, philanthropist, or corporate donor “the customer”? Clearly not.

A final difference is that in the absence of financial objectives, most nonprofits are cause-driven and serve an important social



AP Images/Chuck Burton

Nonprofit organizations rely on funding from philanthropists, foundations, corporations, and individual charitable donations to raise funds.

purpose. This makes it hard to determine how well a nonprofit is doing. Instead of measuring the economic value created, which is relatively easy for a for-profit corporation, measuring the social value created is far more difficult. For example, the mission of Habitat for Humanity is not building houses efficiently (on which measure it would score low since building takes place only on weekends when volunteers are available) but is it rather to build houses for people who could not afford it, to add to the social capital generated when individuals contribute to their community and to the welfare of others (Magretta, 2002).

Unique Challenges for Nonprofits

Nonprofits rely on funding—whether from foundations, philanthropists, alumni, or charitable donations—from sources and people that believe in the cause or social purpose to which the nonprofit is committed. So fundraising is a constant challenge for nonprofits, and administrative costs for doing so (for example, widely distributing mailers to targeted prospective donors as well as paying for such lists) are appreciable and unending.

Again counterintuitively, just because they are nonprofits doesn't mean they don't compete. They compete for funding, for good people, and for clients. A museum or opera company, for example, competes with all other forms of entertainment and leisure activities for patrons. The Chronicle of Philanthropy maintains a list called the "Philanthropy 400" of the nonprofits that annually raise the highest amount of funds. The 400 institutions in the survey in 2009 raised \$68.6-billion, though the drop they suffered in contributions that year (11% over the previous year) was nearly four times as great as the next biggest annual decrease: 2.8% in 2001, when charities also struggled to raise money from recession-battered donors (Barton & Hall, 2010). There are many examples of nonprofits competing. Kaiser Permanente, the largest nonprofit HMO (health maintenance organization) in the United States, competes with for-profits for subscribers. David Lawrence, then chairman and CEO, wondered, "Was it possible to compete in the marketplace and, at the same time, remain true to our social mission?" (Magretta, 2002, p. 90). The Metropolitan Museum of Art competes with other museums, art institutions, and private collections worldwide when bidding for art works to add to their collections.

Another major challenge is recruiting people to work in the nonprofit who share the values and social purpose of the organization. Sometimes, people happily find the organization and apply to work there. But that alone is insufficient; they must also have the requisite skills and management experience of the position to be filled. It is tempting to fill a position with someone that has the skills and experience but not the values and mission of the enterprise.

Another challenge is deciding on what objectives to achieve. A nonprofit that is committed to reducing the teenage crime rate in a community through conducting classes for high-school students shouldn't be measuring the number of classes taught and the attendance at each class, but rather the extent to which the teen-crime rate in the area discussed declines. How might the Red Cross, to use a complex, global nonprofit, measure how effectively it is achieving its mission? Should foundations focus on the number of grants they've awarded or on the outcomes those grants were designed to produce? Parents and taxpayers alike (not to mention the school principals involved) would like public education to do a better job of educating students—but what exactly is meant by "better education" or "an effective teacher" or "student learning"? Translating the nonprofit's mission into measurable performance outcomes is not easy, and without such measures no one in the organization or that depends on it will know what is expected of them. What gets measured gets managed, in any kind of organization, and that means measuring *results*, not activity (Magretta, 2002).

Yet another challenge is competing for clients, just like for-profits. Museums, to be viable, must still advertise to get people to come to see their exhibits. Similarly, symphony orchestras, opera companies, and theater-production companies must get people to come to their performances.

A final challenge for some but not all nonprofits is maintaining their status as nonprofits. Things change over time, and some nonprofits start profit-making businesses (like cafeterias, websites) and must declare profits from such operations as income. If those initiatives grow, the relative amount of profit and the divergence from the stated mission could cause a problem in maintaining the nonprofit's tax-exempt status.

Case Study

Measuring Effectiveness in Ashoka

Ashoka is a multinational nonprofit organization dedicated to finding and supporting true social entrepreneurs. It believes that social entrepreneurs create innovative solutions, deliver extraordinary results, and improve the lives of millions of people. By finding and supporting them, Ashoka leverages its influence for benefiting society. Since it began, it has supported more than 1,800 social entrepreneurs, called Ashoka Fellows ("Fellows"), in more than 60 countries around the world. The enterprises they indirectly sponsor range from agriculture to public health.

Ashoka is interested not only in the immediate success of its Fellows, but also in the enduring value that they have years after their funding has finished. Here's how it measures this value.

Each year, Ashoka conducts a Measuring Effectiveness study focusing on the Fellows selected in the past 5–10 years. The study includes a survey sent to all Fellows elected in a given year, as well as a series of in-person interviews with a cross-section of survey respondents. The survey features the following indicators of success and social impact:

1. Original vision: Is the Fellow still working toward his or her original vision? (Five years later, 94% of Fellows say they are.)
2. Independent replication: Are others mimicking the programs started by the Fellows? (Five years later, 93% of Fellows say yes.)
3. Policy influence: Have the Fellows' programs influenced public policy? (Five years later, 56% respond affirmatively.)
4. Leadership building: Have Fellows developed into leaders in their fields? (Five years later, 54% of Fellows have.)
5. Leverage: How did Ashoka support, help Fellows to succeed? This measure looks at how the stipend, collaboration, communications assistance, and other dimensions of Ashoka support helped the Fellows.

Ashoka's approach is far ahead of the field simply because it desires to measure its long-term social impacts.

Source: Ashoka, *measuring effectiveness: A six-year summary of methodology and findings*. Arlington, VA: Ashoka, 2006; and www.ashoka.org, as cited in Arthur C. Brooks, *Social entrepreneurship: A modern approach to social value creation*. Upper Saddle River, NJ: Pearson Prentice-Hall.

Strategic Management for Nonprofits

Just as for-profits need to know what not to do as well as what to do, so also do nonprofits; it is a hallmark of strategy. Small nonprofits have clear missions and an unequivocal direction. However,

some larger ones are faced with choices that might alter their mission (or not if they ignore the choices), and so should engage in strategic thinking and strategic planning. For example, Habitat for Humanity, discussed earlier, builds homes in stable communities that allow local merchants, volunteers, and the future homeowner to contribute to each other's welfare in a true grassroots endeavor. Should it extend its efforts to urban homelessness or disaster relief? Does that fit its business model, social mission and what makes it unique (Magretta, 2002)?

In today's rapidly changing environment of scarce resources, nonprofits need to behave as tough competitors and thus constantly be aware of how their environment is changing and what it takes to stay on course. The need to manage strategically is more acute than ever.

And when a nonprofit is changing course and has to revise its mission, it doesn't need to get permission from its sponsors for making such strategic decisions, but it does need to be clear on its new mission and why it was changed. And it needs to make sure that its stakeholders or members also share that revised mission.

Discussion Questions

1. Think of 2–3 nonprofits to which you contribute or would like to contribute (i.e., with whose cause or social purpose you identify). It is one thing to know how the nonprofit is spending the money it receives from people like you, but do you know how well it is achieving its mission? If you don't, why is that?
2. Many benefactors feel good when they give donations (both cash and in-kind) to a charity, and not just because they get a tax deduction for doing so. But they don't read the letter and pamphlet showing what they have accomplished and what there is still to accomplish that many charities send only to donors. Is there a solution to this problem? Is it a problem?
3. Many famous private universities have huge endowments and are actually very well off. Give one or more good reasons why they should retain their tax exempt status.
4. Following (3), why should alumni get a tax deduction for giving to an alma mater that is, actually, very well off financially?
5. Many social-welfare nonprofits, like hospitals, care for the indigent; hospices, etc. rely on donations from the general public as well as benefactors. Why doesn't the government support them? (The government does provide support in many areas like health for seniors (Medicare), education, the arts, and cancer research, to name a few.)

Summary

This chapter focused on the difficulties and added complexity of strategic management in complex organizations. Multibusiness organizations simply have more than one strategic business unit (SBU) to run, and choose carefully who will head up each one. When the number of SBUs owned reaches the high double-digits, the company has to manage a portfolio of companies and make sure each one is performing to the best of its ability and that its strategy makes sense. In such organizations, management must rely more on financial results to assess the SBU. If its current portfolio is not achieving financial objectives set for the corporation as a whole, it has the ability to sell off those that are underperforming and acquire more highly performing companies. Diversified corporations have, by definition, subsidiaries or divisions that are in different industries or in very different segments of the same industry, unlike multibusiness corporations, which could have companies in the same industry. Both have to manage portfolios of companies.

When companies expand into the international arena, they do so either because their home market has matured or because they see real opportunities in foreign markets. The key international-expansion strategies are exporting (no presence in the host country is required), market expansion (requires sales offices in the host country), manufacturing in the host country (if tariffs or transportation costs get too high), forming strategic alliances (principally with distributors and because alliances are expected in order to enter some countries like Japan), forming joint ventures and acquiring a company in the host country (usually but not exclusively in the same industry). Companies who develop a core competence in a particular strategy will fare very well.

Startups and emerging businesses have no history of performance and begin their existence with a single-minded market-entry strategy. The only questions they must answer are whether there is sufficient demand for the product, whether they can compete with existing companies, and whether they can be profitable. Because strategic planning involves choices—what to do and what not to do—startups and very young businesses need a business plan to guide them (and raise the required startup capital), not strategic planning.

As a small business grows, typically beyond \$10 million in annual revenues, its systems and organizational processes become more sophisticated, its managers more experienced, and the need for doing strategic planning more pronounced. However, if such a company has never done strategic planning, it faces the challenges of training its managers to do and believe in strategic planning, and to go through the inevitable change process that ensues. Even finding the right strategic/change consultant can present a problem.

Nonprofits are ubiquitous in the United States and cover the gamut of types including arts organizations, universities, hospitals, religious organizations and charities, labor unions, foundations, and neighborhood organizations, to name a few. They differ from for-profit companies in that they are financed in most cases by a third party (not their customers or banks), are cause-driven, serve a social purpose, and qualify as tax-exempt. Counterintuitively, nonprofits are highly competitive; they compete for funding for good staff and for clients. They would be well advised to adopt the competitive mindset of for-profit corporations. Nonprofits cannot use financial measures to denote how well they are doing, but rather have to devise ways to measure the extent to which they are achieving their social purpose, a more difficult task and one not done well by many nonprofits. Translating their mission into objectives that clarify the organization's mission is perhaps their greatest challenge.

To be sure, some aspects of managing these more complex organizations are similar to what has been discussed in the previous nine chapters, but managing these more complex organizations presents more challenges.

Key Terms

angel investor A former entrepreneur that has become wealthy from cashing out prior ventures and wants to help other entrepreneurs in the same field.

cross-distribution alliance An agreement between two companies in different countries to market and distribute each other's products in the other's country.

conglomerate A corporation whose portfolio companies are in unrelated businesses.

diversified corporation *See conglomerate.*

franchising An agreement with an independent company to capitalize, open, and operate identical stores/restaurants for an upfront fee and royalties based on gross sales in exchange for the right to use the brand, exclusivity in a certain market area (or country), access to suppliers, training, advertising, and other assistance.

global corporation One that utilizes a centralized strategy and marketing approach for a product that satisfies customers in different countries without modification and can purchase, produce, do R&D, and direct operations from anywhere in the world.

international corporation One that manufactures a product in its home country and distributes and sells it in foreign countries. (Outsourcing to foreign manufacturers does not make a corporation “international.”)

joint venture A strategic alliance that requires the formation of a separate corporate entity jointly owned by the two companies that formed it and governed by an agreement between the two parties.

multibusiness corporation One that owns more than one strategic business unit or is in more than one business.

multidomestic strategy Tailoring a product (including modifying its features, packaging, advertising, service-delivery methods, and pricing) to the varying demands and needs of customers in different countries, making centralized control virtually impossible.

nonprofit organization One that has a mission reflecting a social purpose; relies on tax-deductible contributions from corporations, foundations, philanthropists, and individuals for its funding; does not measure success in financial terms; and qualifies as a tax-exempt organization by state and federal tax authorities.

small businesses Privately owned and operated businesses with a small number of employees and relatively low volume of sales.

startup A company, venture, or organization that comes into being the moment money is expended in its behalf (not when revenues are achieved or it is registered).

strategic business unit (SBU) A single-business company that competes in a specific industry with specific competitors and requires unique strategies and financial resources to enable it, with someone accountable for what it achieves (typically the CEO).

transnational strategy A global strategy that capitalizes on efficiencies and economies of scale while being locally responsive—adapting its product in some way to certain markets.

venture capitalist A person that invests in a startup or expanding business venture with potential to achieve significant returns on invested capital.

