

INTERNATIONAL BUSINESS

Exam, 12.5.2016

Examiner: Ville-Pekka Sorsa

1. Explain the following concepts as understood in context of international business:

- a) Location economies and learning curve effects (7,5 points)
- b) Worldwide product divisional structure and worldwide area structure (7,5 points)

2. Compare the advantages and disadvantages of franchising and greenfield investment (through a wholly-owned subsidiary) as entry modes. (15 points)

3. Read the following case description and answer the two questions.

Puzzle Group (fictional case) is an international premium toy manufacturer incorporated in Finland. Puzzle originally followed a cautious internationalization strategy. In the beginning, all its activities were based in Finland. It first started to export toys to a few selected European countries and later to the United States. After significant expansion in sales and demand for its products in these markets, it decided to add new product lines and move its toy manufacturing operations to environments with lower overall production costs. Puzzle has now outsourced manufacturing of toys to be sold in the European market to Estonia through a long-term licensing agreement with a medium-size firm called Lelutehas. For all other markets, Puzzle's toy manufacturing occurs in one wholly owned subsidiary, Puzzle China, whose operations take place at the Guangzhou Export Processing Zone in Southern China. All R&D activities reside in Finland. All marketing and sales activities of the Puzzle Group are coordinated from Finland apart from these activities in China, for which Puzzle China is responsible. The Puzzle group uses dozens of small firm partners in fifty countries to implement its marketing strategies at the grassroots level.

In the premium toy industry, pressures for cost reductions are very high globally. The pressures for local responsiveness depend on the market. European consumers tend to want new, innovative products. On average, they are willing to pay more than consumers in other markets and the same consumer groups in different European countries tend to have similar tastes (determined by, among other things, income levels of the parents and the gender of the child). In the European market, Puzzle offers all types of small products from high-end action figures to educational toys for

schoolchildren. Yet, Puzzle group makes most of its sales in the American market. The American premium toy market is similar to Europe's, but there competition is more rife. As result, Puzzle has decided to focus on selling only two of its most profitable products – two high-end action figure lines – in the US.

Being a pioneer in the high-end toy industry in Europe, Lelutehas uses flexible and innovative technology (including 3D printing), which allows somewhat rapid changes to different product lines. However, the costs of each change are relatively high, and adopting new product lines typically leads to less efficient manufacturing in existing lines. The HRM director of the Puzzle group has suspected that Lelutehas just cannot find enough skilled workforce for its operations in Estonia. Puzzle China, which produces toys for all other markets, is the most profitable part of the Puzzle group. This is due to its efficient just-in-time production, which closely follows American demand for Puzzle's products. Thanks to the profitability of the Chinese subsidiary, Puzzle has been able to produce a stable return on investment for its shareholders.

Puzzle China has requested the Finnish headquarters to give it more freedom in designing the products, creating more locally rooted marketing venues, and developing internet-based sales in China. Most importantly, it wishes to start producing 'smart' outdoor equipment for playgrounds for the East Asian and North American markets. Unlike most toy firms operating in China, the subsidiary has young and highly motivated managers, who have broad networks among Chinese toy retailers and public officials as well as marketing professionals in Guangzhou. They also have good personal connections to some of the best young Asian designers of playground equipment thanks to previous collaborations in the Guangzhou area. Puzzle China believes that becoming a pioneer in the Chinese smart playground market will certainly pay off in the future. It argues that the Chinese central government has signaled a new urban planning policy that is favorable to building new playgrounds. Puzzle China also argues that it could compete effectively in the American market thanks to providing high-end equipment with lower costs and thus offering more value for money for various types of clients.

In principle, the Finnish parent company supports the idea of entering the smart playground market, since Finland is known for its success in educational issues, the Finnish design of educational toys has been internationally appraised, and Finnish firms have a reputation as responsible producers of 'smart' equipment. However, the Finnish directors have thus far denied their Chinese subsidiary's requests. The directors fear that it would cause additional research and development costs, which would reduce the profitability of manufacturing operations for the American market. The directors do not want to alarm their main majority shareholders, who are known for active engagement for improving the profitability of the firms they own. The headquarters are also skeptic toward Puzzle China's ability to beat local players in the American smart playground market. They believe that American competitors can start to compete on price levels more effectively than Puzzle China assumes.

Puzzle has recently come under severe media pressure in Finland. There have been well-grounded accusations that its main European partner Lelutehas has forced its small staff to work overtime without extra compensations. Meanwhile, a British newspaper has provided indisputable evidence on three suicides among the employees of Puzzle China's main component supplier. Rumors over inhuman management practices at the supplier are getting wild in the Finnish media. Seeing Puzzle as a socially responsible firm, the directors have been disappointed with this development. The Finnish headquarters have tried to ensure that all its partners and its Chinese subsidiary follow the firm's official code of conduct on labor issues, which states that each national subsidiary is responsible for assessing their main suppliers' social and environmental performance. The executives of Puzzle China insist that they have followed all the instructions exactly as presented by the headquarters. However, they have not provided any concrete evidence on how they have assessed their suppliers' activities or applied the group's code of conduct.

Now, answer these two questions:

- a) What kind of international business strategy has Puzzle adopted? What kinds of advantages does this strategy provide, given the nature of the premium toy industry? (9 points)
- b) What kind of micro-politics is currently taking place within the Puzzle group (4 points)? In what way is it relevant to the social responsiveness of the Puzzle group (2 points)?

JOKER QUESTION (2 extra points): In comparative political economy, Estonia is usually classified as a Dependent Market Economy. What are the main general characteristics of firms in this kind of variety of capitalism? As a firm, is Lelutehas typical to Dependent Market Economies?