TRENDS IN GLOBAL SEGMENTATION AND THEIR IMPACT ON DYNAMIC CAPABILITIES AND COMPETITIVE ADVANTAGE: A shift away from global integration and national adaptation

Abstract

This article represents the theoretical foundation for a description of the impact of globalization, and in particular the growth of 'inter-market' segments on MNE global strategy. Furthermore, the study suggests that the debate on key firm capabilities in global competition needs to be broadened beyond the discussion of national adaptation and global integration. While still influential these dichotomous strategies seem no longer to be the sole sources of sustained competitive advantage. This study proposes that sustained global competitive advantage, in particular for global firms, rests on their ability to segment customers according to real differences in benefits sought rather than increasingly arbitrary demographic and geographic criteria. Over recent years we believe that due to both sea changes in consumer demand patterns and increasing global competition, there has been an increase in the size, number, and diversity of cross-border or ‘inter-market’ consumers segments. In response we believe that MNEs have been shifting the focus of their global strategy away from issues of national adaptation and global integration of national activities to developing the capabilities for identifying ’inter-market' segments, serving them, and finding synergies between them. Finally, we believe that such an approach is allowing MNEs to simultaneously use cost and differentiation benefits to improve their competitive position.

This study concludes with a testable conceptual framework based on four propositions. The plan is to test these propositions with the data collected from in-depth interviews with high-level managers from Finnish based MNEs.

1. Introduction

Globalization is a phenomenon that has been traditionally described using two dichotomous concepts, global integration and national adaptation. The logic follows that in response to globalization a firm can develop capabilities in either adaptation or integration, (Hout et al. 1982; Yip 2003) or a mix of both (Barlett & Ghoshal 1988; Douglas & Wind 1996). However it seems increasingly difficult to reconcile these simple, opposing concepts with the realities facing modern global firms. Rugman & Verbecke (2004) state that while “national-responsiveness and localized adaptation are almost universally advocated as a panacea for penetrating international markets, in reality most MNEs attempt to add value primarily by capitalizing on similarities across markets”. Furthermore, they go on to state that the scale benefits of integration, while important, may not be the main focus of the firm’s global upstream strategy, rather it is differences in market factor costs. In general what seems to be happening is that the combined globalization impacts, i.e. increasing market interdependences, lower national boundaries and maturing global competition is shifting the competitive emphasis away from national adaptation and/or global integration. In mature global industries, such as telecommunications, competition is increasingly oligopolistic and transparent (Solberg 2000). For example, Nokia and its competitors all seem well aware of opportunities for global sourcing and market standardization, they are also equally aware of need to be culturally sensitive. Furthermore, even if one company gets a head start with a standardization/adaptation (S/A) competence it is quickly imitated. As such it has become hard with the existing S/A literature to identify the underlying capabilities that firms like Nokia are building their global success on. Possibly in response to these weaknesses of S/A literature recent studies, such as Hassan et al. (2003), suggest that the new basis for sustained global competitive advantage is effective global 'benefit' segmentation. This study promote that successful global firms compete by identifying, and serving one of a growing number of 'real' consumer needs that transcend national, regional, and even continental boundaries. Based on these recent developments the objective of this study is to assess how globalization is impacting the firm’s segmentation strategies and capabilities. In order to link globalization changes to firm competitive advantage this paper will look at the whole strategic process of the firm. This requires discussion of four streams of literature 1) globalization drivers 2) global segmentation 3) global competitive strategy 4) dynamic capabilities. These are then used to formulate research propositions and a conceptual framework which will be tested by an empirical study at a later date.

2. Literature review

2.1. Globalization Drivers and Segmentation

Globalization, at least in the arena of international business, is seen as a movement away from 'local autonomy and adaptation towards global integration and uniformity' (Yip 1994; 529). The logic follows that in order not be caught out by this movement firms operating in the global environment need to first assess the strength of the globalization drivers within their industry and adjust their global strategy to match them. According to Yip (2003) there are four types of industry globalization drivers: market, cost, governmental, and competitive, and the firm can respond to them by changing the dimensions (or levers) of its global strategy: market participation, product standardization, activity location, and uniform marketing. Of particular interest to this study is the key market driver of increasing global commonality of consumer needs and tastes (Levitt 1983; Yip 2003). In response to this trend there has arisen various models of cross-border segmentation, from regional segments (Daniels 1987), to cross-cultural segments (Whitlock 1987), and global segments (Hassan & Katsanis 1991).

This study focuses on the latter model of global segments, or 'inter-market' segments (Hassan & Blackwell 1994), as it is the most comprehensive, utilizing both macro and micro level criteria. Inter-segments are defined as groups of customers who transcend traditionally defined geographic boundaries (Hassan & Blackwell 1994).The origins of the 'inter-market' segment lies in to the rise of the 'global consumer', who buys the same brands promoted globally (Hassan et al. 2003). The key to creating 'inter-market' segments is the shifting of the emphasis of the segmentation process away from demographic and geographic criteria towards understanding customer psychographics, i.e. consumer psychology (Haley 1983). In the words of Christensen et al. (2005)”you need to segment markets in ways that reflect how customers actually live their lives", that is according to what problems they need solved and/or what benefits they are seeking (Haley 1983). By segmenting in such a way it is said that a firm benefits both from within segment standardization (e.g. lower cost and better quality) and within segment adaptation (e.g. close to the needs of consumers) (Steenkamp & Hofstede 2002). While the authors of this study agree with the premises of inter-market 'benefit' segmentation, we believe that such models fail to fully realise and/or describe the impact of global segments on firm global strategy and subsequent firm competitive position. In particular we suggest that the literature under-emphasises the impact of 1) increasing number and diversify of global segments and 2) segment interrelationships and synergies.

To explain the first point, the generally accepted idea of increasing customer commonality are incomplete; while it is true that needs and tastes are becoming more global it is also true that the diversity of needs and tastes within countries is increasing, creating evermore fine-grained 'inter-market' segments (Hofstede et al. 2002). We believe the influence of 'inter-market' segmentation is increasing because of: 1) the increased consumer awareness of products and/or services that satisfy their individual needs and tastes, 2) a continued splintering of these globally spread consumer groups as firm in increasingly competitive industries focus more on satisfying more obscure needs and tastes, thus creating more diverse segments. Although other authors, e.g. Hofstede et al. (2002), have mentioned such trends there is yet to be research that addresses their existence and evolution empirically and pinpoint their impact on firm global strategy, hence proposition 1:

Proposition 1: Globalization has, in mature industries, increased the number and diversity of 'inter-market' segment.

Moving to the second issue, according to Porter (1985) segment interrelationship refers the sharing of different value chain activities across segments. As identified by Porter (1985), technology developments have been lowering the costs of competing in different segments via increased integration of upstream activities such as production and R&D. In more recent time however, advances in communication technology, in particular the development of the Internet, have also allowed firms to integrate downstream activities across segments. In the days of Porter's (1985) book it can be argued that the interrelationship between segments was fairly underdeveloped and consequently the firms taking advantage of them were focusing on a small number of narrow segments, i.e. a focused strategy. To be a large MNE required targeting a broad spectrum of fairly unrelated segments; thus incurring *costs of compromise* as to be good in all segments is to be a master of none (Porter 1985). A firm was either *focused*, i.e. "selects a segment or group of segments in the industry and tailors its strategy to serving them to the exclusion of others" or *broad* in sense that the firm is operating in fairly unrelated segments requiring the firm to incur *cost of co-ordination, compromise and inflexibility* (Porter 1985; 263). This study wonders to what extent developments in technologies and in the form and number of 'inter-market' segments have increased the opportunities for segment inter-relationships and blurred the line between the 'focused' and 'broad' firm.

Proposition 2: Globalization in mature industries is increasing the opportunities for interrelationships between 'inter-market' segments.

2.2. Global strategy and organizational capabilities

How does globalization impact MNE global strategy and consequently firm competitive position? As mentioned above Yip (2003) in his matching of globalization and global strategy, a firm has four 'levers' by which it can respond to globalization: market participation, product standardization, activity location, and uniform marketing. As, in the opinion of Yip (1994), and Levitt (1983), globalization leads to more opportunities for global integration across countries, the four the focus of the levers should shift towards taking advantage of global integration benefits, i.e. economies of scale and scope and improved quality. In essence what is being promoted is a shift from costly but differentiating national adaptation strategies towards low cost but standard global integration strategies. Yip (2003) is suggesting that developing capabilities in integration means sacrificing capabilities in adaptation and vice versa, this is in line with Porter's (1985) ideas that cost and differentiation leadership are mutually exclusive. However, there has been much debate, in both the Global Standardization/National Adaptation and Cost/Differentiation literature, of whether such strategic purity really holds true. Studies by, for example Hill (1988) and Murray (1988), suggests that Differentiation and Low-Cost can be emphasised simultaneously. Also, as mentioned before, the trans-national approach (Bartlett & Ghoshal 1988) promotes the simultaneously use of both national adaptation and global integration strategies. While this study believes that cost and differentiation are not mutually exclusive we suggest that by focusing on the national adaptation/global integration some authors in the global strategy field are ignoring other dimensions of global strategy that allow simultaneous pursuit of cost and differentiation advantages. In particular how has the phenomenon of 'inter-market' segments impacted the global strategy of firms? Furthermore, what are the opportunities for cost and/or differentiation advantages for a firm facing an increasing number and diversity of cross national/continental segments?

Kim & Mauborgne (2004) suggest that globalization has shifted the emphasis of global competitive strategy away from either cost or differentiation towards their simultaneous pursuit. They propose that both lowering cost and increasing buyer value can be obtained if the firm pursues a *blue ocean strategy,* in that it creates and focuses on “uncontested market space” making competition irrelevant. This requires the firm to appeal to “a whole new group of customers who were traditionally non-customers of the industry” (ibid 2004:77). Appealing to a whole new group of customers requires the firm to re-evaluate the components of its offering. This re-evaluation is done using four questions (Kim & Mauborgne 2005):

Which factors should be reduced well below the industry standard?
Which factors should be created that the industry never offered?
Which factors should be raised well above the industry standard?
Which of the factors that the industry takes for granted should be eliminated?

Similar to 'inter-market' segmentation this approach requires the firm to understand how customers' needs, both current and latent, are evolving, i.e. a market orientated approach (Slater & Narver 1999). Being market orientated means placing the customer rather than abstract notions of cost or differentiation or global standardization and national adaptation, in the centre of competitive strategy. That is not to say that these concepts are not important, instead they are the means to an end rather than the end itself (Douglas & Wind 1987). This shift away from pure strategies of cost or differentiation towards customer responsiveness is strongly evident in mature global industries characterised by fierce competition (Kim and Mauborgne 2005). In such industries it seems that the flexibility and availability of resources combined with intense competition has forced large incumbent firms to seek both low cost and differentiation. The pursuit of 'mixed strategies' (Hill 1988) has raised interesting issues regarding the anchoring of competitive strategy. One could argue that in the past firms following a pure competitive strategy had only to choose strategies that furthered the pursuit of that strategy, either lowering costs or raising differentiation.

If these simple goals are replaced with the vague pursuit of a 'mixed strategy', how is a firm to know what is the optimal mix? The answer, according to the market orientation (Slater & Narver 1999), is that the optimal competitive strategy is the one that best serves the current and latent needs of the consumer. In the global context this mix of competitive strategy might have meant the firm implementing both national adaptation and global integration strategies (Barlett & Ghoshal 1988). However true this may be, as mentioned before, such assertions are tied to the global integration/national adaptation rhetoric and consequently exclude 'inter-market' developments. In response to this perceived gap *Proposition 3* below is an attempt to explain the impact of 'inter-market' segment developments of firm generic competitive strategy and eventually firm competitive position relevant to other industry operators.

Proposition 3: Rather than emphasizing cost versus differentiation, inter-market segmentation is allowing firms to implement mixed strategies tailored to achieve an optimal level of global customer responsiveness and global segment inter-relation that improves firm competitive position.

In order to complete the picture this study will also look at the underlying foundations for competitive advantage in changing environments; dynamic capabilities (Teece et al. 1997). Dynamic capabilities are defined as the firm's ability to 'integrate, build, and reconfigure internal and external firm-specific assets (i.e. resources) to address rapidly changing environments' (Teece et al. 1997; 516).The ability to respond to rapidly changing environmental changes is directly related to the firms ability to achieve sustainable competitive advantage (Teece et al. 1997; Eisenhardt & Martin 2000). Firm-specific assets are themselves usually grouped enabling distinctive activities, i.e. organizational routines and processes, to be performed (Teece et al. 1997). Segmentation as an organizational and strategic process is an example of a dynamic capability as it *can* 'create value for firms within dynamic markets by manipulating resources into new value-creating strategies' (Eisenhardt & Martin 2000; 1106). In other words a firm to have a dynamic capabilities in segmentation, it must be able to continually match its segmentation strategy to the changing environment. The logic follows therefore that if a firm manages to continually match its segmentation strategy to the environment in new and innovative ways, i.e. different to other firms in the same environment, it could achieve sustainable competitive advantage - depending on underlying resources and path dependencies (Eisenhardt & Martin 2000).

We promote, based on the literature, that recent changes in the global environment represent an opportunity for global firms to develop dynamic capabilities in segmentation, capabilities that can lead to sustainable competitive advantage. This some what disagrees with the traditional global strategy literature suggesting that global firms require dynamic capabilities in either global integration or national adaptation (Yip 2003) or both (Barlett and Ghoshal 1988). That is not to say that global integration and national adaptation are not important, rather that the global firm needs place emphasis on building new resources and capabilities in response to globalization developments: the appearance and growth of global segments and segment interrelationship opportunities. To capitalize on such developments the firm needs to implement organizational processes that simultaneously and continuously identify and maintain global customer segments, and also find ways to interrelate them.

Proposition 4: Inter-market segmentation is inducing global firms to develop dynamic capabilities that would enable them to respond to evolving global segmentation opportunities.

3. Conceptual Framework

The conceptual framework below represents a simplification of the main logic of the article. Interdependent variable of globalization is represented by altering the traditional globalization drivers of Yip (2003), i.e. government, competition, market, and cost, to include both the increasing number of diversity of 'inter-market' segments and also the drivers for increased cross-segment synergies and not just cross-country integration. These drivers then in turn push the firm to re-assess its global segmentation strategy by 1) increasing customer responsiveness and thus improving 'inter-market' segment identification, and 2) increasing inter-market segment inter-relations. However, as well as external globalization drivers firm strategy is also affected by internal organizational factors (Zou & Cavusgil 1996), such as the dynamic capabilities of the firm.

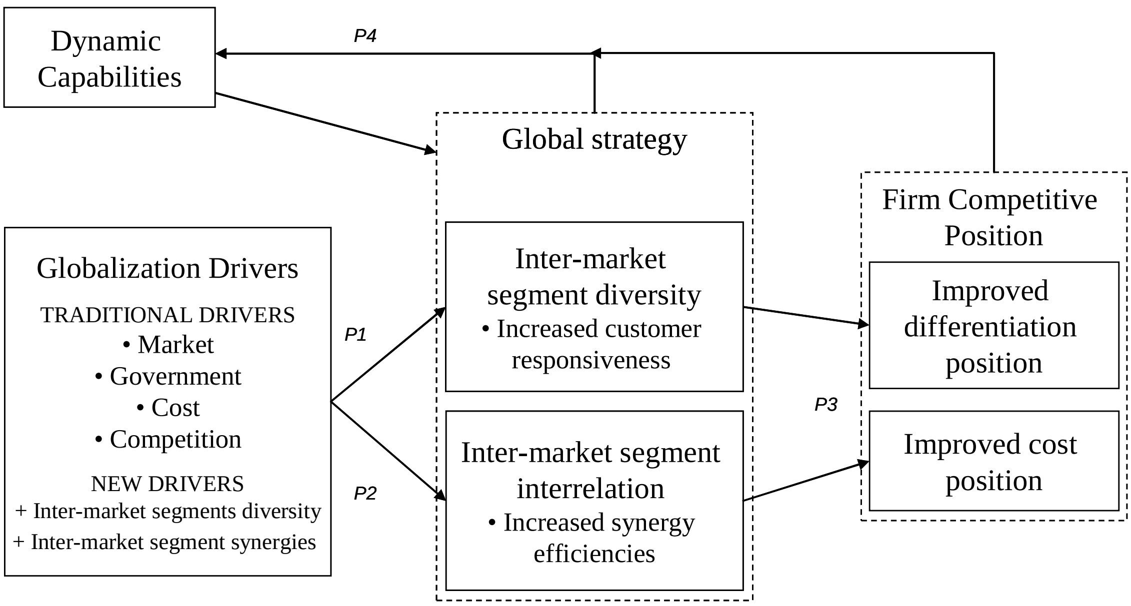

Figure 1: The impact of globalization on firm global competitive strategy

4. Conclusions

When complete this study hopes to broaden the debate on the sources of global sustainable competitive advantage. In particular the study hopes to assess whether the emphasis of the current global strategy literature on global integration and local adaptation is too narrow to accurately describe the response of MNEs to globalization impacts. We believe that globalization has progressed to a point where sustained global competitive advantage is no-longer achievable solely by making the right national adaptation and global standardization decisions. To lead the competition firms have to follow a process whereby 1) they identify the real global customer needs, 2) create global segments by looking for the similarities between those needs across markets and 3) look for interrelationship opportunities between segments. By taking a global customer perspective MNEs can develop the right segmentation capabilities to allow them to pursue a tailored, unique, and consequently sustainable, value adding competitive strategy in the rapidly changing global environment. Confirmation of the propositions would suggests that prescriptive national adaptation/global integration literature, such as Yip (1989, 2003) and Barlett and Ghoshal (1989), is becoming less useful to global firms as it under emphasises the increasing occurrence and importance of global segments and segments interrelationships.

The authors intend to use interview data from various Finnish MNEs to test the propositions. Interview data regarding globalization drivers has already been collected during the spring of 2007. Further in-depth interviews with the managers of Finnish MNCs are scheduled for the fall 2007, with the aim of releasing preliminary results before the end of the year.

5. References

Barlett, C.A. & Ghoshal, S. (1988). Organizing for worldwide effectiveness: the transnational solution. *California Management Review,* 31/1, 54-74

Bonoma, T.V. & Shapiro, B.P (1984) Evaluating Market segmentation Approaches. *Industrial Marketing Management*, 13, 257-268

Clayton, M.C., Cook, S. and Hall, T (2005) Marketing Malpractice: The Cause and the Cure. *Harvard Business Review*, Dec, 74-83

Craig, C.S. and Douglas, S.P. (1996). Responding to the Challenges of Global markets:

Change, Complexity, Competition and Conscience. *Columbia Journal of World Business*, winter, 6-18

Daniels, J.D. (1987). Bridging national and global marketing strategies through regional operations. *International Marketing Review*, 2/3, 29-44

Douglas, S.P. & Wind, Y. (2001). The Myth of Globalization. *Columbia Journal of World Business*, winter, 19-29

Eisenhardt, K.M. & Martin, J.A. (2000). Dynamic Capabilities: What Are They? *Strategic Management Journal*, 21, 1105-1121

Haley, R.I. (1983). Benefit Segmentation-20years later. *Journal of Consumer Research*, 24/1, 19-26

Hassan, S. & Katsanis, L.P. (1991). Identification of global consumer segments: a behavioural framework. *Journal of International Consumer Marketing,* 3/2, 11-29

Hassan, S. & Blackwell, R.D, (1994) *Global Marketing: Perspectives and Cases*, Harcourt Brace & Company, US

Hassan, S., Craft, S. & Kortam, W. (2003). Understanding the new bases for global segmentation. *Journal of Consumer Marketing*, 20/5, 446-462

Hill, C.W.L. (1988). Differentiation versus low cost or differentiation and low cost: a contingency framework. *Academy of Management Review*, 13/3, 401-412

Hofstede, F.T., Wedel, M. & Steenkamp, J-B. E.M. (2002). Identifying Spatial Segments in International Markets. *Marketing Science*, 21/2, 160-177

Hout, T., Porter, M.E. & Rudden, E. (1982). How global companies win out. *Harvard Business Review*, sept-oct, 98-108

Kim, W.C. & Mauborgne, R. (2005). Blue Ocean Strategy: From theory to practice. *California Management Review*, 47/3, 105-121

Levitt, T. (1983). The globalization of markets. *Harvard Business Review*, 61/3, 92-102

Murray AI. (1988). A Contingency view of Porter’s ‘generic strategies’. *The Academy of Management Review*, 13/3, 390-399.

Porter ME. (1985). *Competitive Advantage: Creating and Sustaining Superior Performance.* New York: The Free Press.

Rugman, A.M. & Verbecke, A. (2004). A perspective on regional and global strategies of multinational enterprises. *Journal of International Business Studies*, 35, 3-18

Slater, S.F. & Narver, J.C. (1999). Research Notes and Communications, Market Orientated is

More Than Being Customer-Led. *Strategic Management Journal*, 20/12, 1165-1168

Solberg, C.A. (2000). Educator Insights: Standardization or Adaptation of the International Marketing Mix: The Role of the Local Subsidiary/Representative. *Journal of International Marketing*, 8/1, 78-98

Steenkamp, J-B. E.M. & Hofstede, F.T. (2002). International market segmentation: issues and perspectives. *International Journal of Research Marketing,* 19, 185-213

Teece, D.J., Pisano, G. & Shuen, A. (1997). Dynamic Capabilities and Strategic Management. *Strategic Management Journal*, 18/7, 509-533

Whitlock, J.M. (1987). Global marketing and the case of for international product standardization. *European Journal of Marketing,* 21/9, 32-44

Yip, G. (1994). Industry Drivers of Global Strategy and Organization. *The International Executive*, 36/5, 529-556

Yip G. (2003). *Total global strategy II*. 2nd ed. Upper Saddle River: Prentice Hall.

Zou, S. & Cavusgil, S.T. (1996). Global strategy: a review and an integrated conceptual framework. *European Journal of Marketing*, 30/1, 52-6