

International business strategy flashcard



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72-hours Individual Case Exam 21. 4.

2008 – 24. 4. 2008 Philip Jacek Lange CPR Number: 100286-1719 Answer to Question 1: L’Oreal, established in 1909, is today the world leader among beauty companies. It employs over 60, 000 people (Company Overview, Facts & Figures, 2008) and had consolidated sales of 17063 Million EUR in 2007 (Latest Press Release Corporate, 2008).

L’Oreal sees its mission to further the cause of beauty, and owns branches in Cosmetics, The Body Shop and Dermatology. However, the cosmetics branch is by far the biggest contributor of sales. Moreover, L’Oreal which is headquartered in Paris, can praise itself of having a portfolio of 19 global brands. These include such well-known brands like Lancome, Ralph Lauren, Giorgio Armani, Vichy, and many more (Our Brands, 2008). Over the years, L’Oreal has grown dramatically. In 2001 it sold its products in over 150 countries and had 283 subsidiaries and 46 plants scattered across the globe (Winners of L’Oreal’s first annual..., 2001).

Since multinationality is defined as “ the extent to which business activities span across national boundaries” (Tseng et al, 2007), looking at these numbers then, one might be tempted to say that L’Oreal is truly a multinational company. Despite these impressive international achievements, these numbers do not offer a very clear picture of the extent of L’Oreal’s multinationality. Therefore, I will go on and try to calculate the level of L’Oreal’s multinationality according to the percentage of foreign sales made outside L’Oreal’s home-country – France. Following this approach brings along several problems.

First of all, I have not managed to find any data showing how big the sales are in France, and therefore I have decided to quantitatively assess it in order to calculate the foreign sales ratio. Second, despite L'Oreal's activities encompass branches like 'Cosmetics', 'The Body Shop' and 'Dermatology', the latter two only contribute with only a small percentage of total consolidated sales (Latest Press Release Corporate, 2008): Sales from 'The Body Shop': 787 Million EUR in 2007 Sales from 'Dermatology': 368 Million EUR in 2007 Since total consolidated sales amounted to 17063 Million EUR in 2007, the combined sales from 'The Body Shop' and 'Dermatology' only accounted for less than 7% of total sales (Appendix: Calculation 1). This in turn means that the Cosmetics branch accounts for 93, 2% of total sales. Additionally, due to the lack of information on the dispersion of worldwide sales of 'The Body Shop' and 'Dermatology', I have chosen to take the sales from the Cosmetics branch as representative of total consolidated sales.

It has to be mentioned though that this simplification will lead to an inaccurate calculation of L'Oreal's percentage of foreign sales, but it will still offer a much more precise measure of multinationality than merely the number of subsidiaries and countries where L'Oreal sells its products. In order to calculate L'Oreal's percentage of foreign sales, I have chosen to look at the Cosmetics branch's sales according to geographical zones (Cosmetics branch: 2007 consolidated sales by geographic zone, 2007). It can be seen that sales in Western Europe amount to 7250 Million EUR which account for 45, 6% of consolidated sales of the Cosmetics branch on a worldwide basis. Moreover, (World Presence, 2008) gives us an overview of the European countries where L'Oreal operates in.

Next, from that list of countries, I have selected all countries that constitute Western Europe and aggregated their GDPs. The data on the GDPs, all of them according to the official exchange rates of the year 2007, I have taken from (CIA, The World Factbook, 2008). The reason why I decided to use GDP as a foundation for the calculation of the foreign sales ratio of L'Oreal, is that GDP not only reflects the wealth of a given country, but also its size. It has to be noted though, that GDP does not reflect size per se (China, despite its immense population, has a GDP comparable to the biggest European countries), but considering the fact that Western European countries have similar GDP per Capita levels, GDP seems to be a fairly precise measure of wealth and size. The aggregate GDP of Western Europe according to the official exchange rates of 2007, amounts to 16196, 1 Billion USD.

Since France's GDP amounted to 2515 Billion USD in 2007, France's GDP as a percentage of Western Europe's GDP accounts for approximately 15, 5% (Appendix: Calculation 2). Since I know that L'Oreal's sales in Western Europe are 7250 Million EUR, and that France's share of Western Europe's GDP is approximately 15, 5%, I can go on calculating the approximate sales in France. This I have done by calculating how much 15, 5% is of 7250 Million EUR (Appendix: Calculation 3). It is imperative to note that 1123, 75 Million EUR is only a quantitative assessment of the Cosmetics branch's sales in France, and therefore cannot be taken as the actual sales in France.

This is due to the fact that I haven't included an assessment of the various Western European populations' propensity to buy cosmetics, but simply I have assumed that this propensity is the same across all Western European countries. However, L'Oreal in the eyes of Frenchmen is considered to be

something close to a symbol of national pride. Therefore, in my opinion, Frenchmen are rather more likely to buy cosmetics offered by L’Oreal than the populations of other Western European countries. This in turn means that the actual sales of the Cosmetics branch in France are likely to be larger than 1123, 75 Million EUR. Nevertheless, due to simplicity, I will use the 1123, 75 Million EUR as representative for the Cosmetics branch’s sales in France.

Having quantitatively assessed L’Oreal’s sales in France, I can finally calculate the foreign sales ratio (it is important to note that I still take the Cosmetics branch’s consolidated sales as representative of total consolidated sales of L’Oreal). According to (Cosmetics branch: 2007 consolidated sales by geographic zone, 2007) the Cosmetics branch’s consolidated sales are 15908 Million EUR on a worldwide basis. ‘Knowing’ that sales in France amount to 1123, 75 Million EUR, the percentage of L’Oreal’s sales in France in relation to worldwide sales, account for approximately 7, 1% (Appendix: Calculation 4). This means that since L’Oreal’s sales in France constitute 7, 1% of worldwide sales, then the percentage of foreign sales relative to total sales account for approximately 92, 9%. Having a foreign sales ratio of 92, 9%, L’Oreal’s level of multinationality can be considered as very high indeed. Such a high level of multinationality results in various consequences for L’Oreal.

These consequences can be categorized into positive and negative consequences. Among the positive consequences from further increasing the level of L’Oreal’s multinationality, is an increase in L’Oreal’s brand recognition. Moreover, an increase in L’Oreal’s brand recognition can lead to,

at least in the perception by customers, an increase in product differentiation and product value. This in turn means that L'Oreal can experience higher levels of market power, which is the ability to set prices above marginal costs. What follows is an increase in L'Oreal's profitability (Cabral, 2000) At first sight, tapping into new markets can be considered another positive aspect of an increase in L'Oreal's multinationality. For a company like L'Oreal, having high fixed costs due to immense R&D spending (Science & Research, Key facts and figures, 2008) and low unit production costs (in these terms it is similar to the pharmaceutical industry), tapping into new markets with the existing product line would mean a further utilization of its economies of scale.

Moreover, since there are around 195 countries in the world (Matt Rosenberg, 2008), and since L'Oreal is active in 'only' 150 countries, there is still room for international expansion, and therefore also potential for an increase in sales. However, looking at the countries in which L'Oreal is already present, it seems that all the biggest and most attractive markets are already served by L'Oreal (World Presence, 2008), and therefore the countries that aren't served by L'Oreal are much less attractive for entering. These countries are situated primarily in Central Asia and most of Africa – regions that are severely underdeveloped and with no bright outlook for economic growth in the near future. In short, these unserved regions by L'Oreal are not emerging markets. Further international expansion would bring along increased costs resulting from the need for further coordination and control. These costs might prove not to be outweighed by the benefits, new sales and revenue, of expanding into new markets.

Hence the profitability of such an expansion might be negative. Also of importance is the fact that as L'Oreal would increase its level of multinationality, the more difficult it would be for L'Oreal to maintain its legitimacy. This would be a consequence of an increased size and visibility, which would further expose L'Oreal to attacks from various interest groups (Kostova & Zaheer, 1999). Managerial Recommendations: In the light of the potential consequences of a continuous expansion into new countries, I would suggest that L'Oreal should not expand significantly anymore. Most of the unserved countries by L'Oreal are both underdeveloped and hardly developing. Therefore I think that if L'Oreal should decide to expand into new geographical markets anyway, they should do it very selectively.

Instead of increasing its level of multinationality, L'Oreal should focus on exploiting its existing multinationality through an enhanced emphasis on building brand recognition, especially in emerging markets. Moreover, in order to maintain or even improve their existing legitimacy, L'Oreal should continue to follow its strategy of employing a diverse workforce (Diversity is a priority, 2008). This will help L'Oreal in applying a polycentric approach (Kostova & Zaheer, 1999). Being a former colonial power, 'Frenchness' might be associated negatively in certain regions of the world. On the other hand, in other regions of the world, 'Frenchness' might be a valuable branding asset. Therefore, L'Oreal needs to be able to adapt to new environments, and the polycentric approach is concerned with that.

Answer to Question 2: L'Oreal, a diversified company as it is, faces a lot of new opportunities for entering new industries. It operates in three major branches – Cosmetics, The Body Shop, and Dermatology. As a potential new
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industry that L’Oreal can benefit from entering into, I have chosen the ready-to-drink tea industry. In fact, L’Oreal is already preparing to enter this new industry in a partnership with beverage-giant, Coca-Cola.

The latter company is already serving this market with products like Nestea and Gold Peak, which combined hold a market share of 10, 1%. This makes Coca-Cola a distant third in this market (Coke And L’Oreal Partner On New Health Beverage, 2007). The partnership between L’Oreal and Coca-Cola will result in a tea-centric skincare product called Lumae (Coca-Cola teams up with L’Oreal, 2007) which is supposed to contain ingredients that will help people care for their skin (Coke And L’Oreal Partner On New Health Beverage, 2007). In 2006 the ready-to-drink tea industry was witnessing a rapid growth of 25, 8% (Coke And L’Oreal Partner On New Health Beverage, 2007). An industry growing this fast constitutes a lucrative entry possibility. Moreover, in the words of Larry Trachtenbroit, head of Brain-Twist, a company producing energy drinks: “ Pretty soon there will be a drink for every part of the body and every mood you’re in” (Coke And L’Oreal Partner On New Health Beverage, 2007).

This statement, taken together with the rapid industry growth, illustrates the massive potential for the upcoming future of this industry. Another benefit besides entering a rapidly growing industry, is the reduction of risk resulting from diversification. By having a diversified business portfolio, L’Oreal can increase its survival chances in the future, as it will be better equipped for dealing with economic slowdowns and market dry ups in other industries. Today, as more and more industries get increasingly more mature and competitive, diversification cannot be underestimated. Besides the benefits

outlined above, potential benefits can also stem from synergies derived from research and development, marketing, and costs. These synergies are derived from horizontal relationships, which are associated with related diversification.

Dess et al (2008) defines horizontal relationships the following way in chapter 6: "...businesses sharing intangible resources (e. g. core competencies such as marketing) and tangible resources (e. g. , production facilities, distribution channels).

" The potential synergies that can be derived in relation to the ready-to-drink tea industry, can come from the partnership with Coca-Cola and from within L'Oreal itself. Coca-Cola and L'Oreal could create synergies from pooled negotiating power. This is because the two companies share many of the same distribution channels, and therefore they could exercise increased bargaining power in relation to distributors (e. g.

department stores). Through an increase in bargaining power, L'Oreal and Coca-Cola could negotiate better deals for their common product Lumae. As for the synergies derived from within L'Oreal, they come from various resources, both intangible and tangible. One of the intangible ones is L'Oreal's technological resources. Technological resources are collective goods, which means they can be replicated and shared among different business units without bearing the full costs of re-creating them in every transfer (Tseng et al, 2007). Since L'Oreal is a heavily active in skincare, it could transfer this knowledge, or at least some of it, to its new operations in the ready-to-drink tea industry.

Another intangible resource that could result in synergies are L’Oreal’s marketing resources. Just like technological resources, marketing resources also are collective goods (Tseng et al, 2007). Since Lumae is supposed to be a higher-end product (Coca-Cola teams up with L’Oreal, 2007), L’Oreal’s expertise in marketing its luxury brands can come in handy. Another resource that can greatly enhance the potential benefits of entering the new industry, is L’Oreal’s tangible resources. L’Oreal’s most important tangible resources are in forms of various distribution channels like department stores and specialty stores of its different brands (Our Brands, 2008). Therefore, exploiting these three resources – technological, marketing, and distribution channels – L’Oreal can benefit from economies of scope in this new industry.

L’Oreal needs to ‘cherish’ horizontal relationships between the new industry and the existing ones (Dess et al, 2008). Last but not least, L’Oreal’s marketing resources could raise the brand recognition of Lumae. This would result in product differentiation which ultimately results in an increase in market power. Lumae can be considered as a related business of the dermatology branch of L’Oreal, as it adds a new activity to old ones. The new activity in this case is Lumae, a tea with ingredients that lead to skincare abilities. The old activities encompass the Active Cosmetics brands which serve a similar purpose.

Furthermore, Lumae can be classified as Related-Constrained. Rumelt (1974) defines a Related-Constrained business the following way: “ Related Business firms that have diversified chiefly by relating new businesses to a specific central skill or resource and in which, therefore, each business

activity is related to almost all of the other business activities” Lumae draws on certain specific resources – technological, marketing, and distribution channels – which relates the new product in the new industry to the dermatology and cosmetics branches, with the exception of The Body Shop branch. Therefore Lumae can be classified as a Related-Constrained diversification. Entering new geographical markets and product markets is always associated with the need to consider possible problems with establishing and maintaining legitimacy.

In terms of environmental complexity, Kostova and Zaheer (1999) argue that the greater the number and variety of countries in which an MNE operates, the easier it will be to establish legitimacy. However, it will also be more difficult for the MNE to maintain its legitimacy. Moreover, the greater the institutional distance between the home country of the MNE and the host country, the greater the difficulty in establishing and maintaining legitimacy in that host country. Following this logic, L’Oreal having a very high level of multinationality, can be expected to have a lot of experience in establishing legitimacy. Moreover, because Lumae will be a higher-end product (Coca-Cola teams up with L’Oreal, 2007), means that it will most probably be sold at first in the rich and developed world – Western Europe, North America, Japan, Australia – since the developing countries may simply offer to little a market for this particular product. Despite certain differences, the institutional distance tends to be relatively low between western countries, and therefore L’Oreal isn’t likely to experience legitimacy problems in terms of the environmental complexity.

Kostova and Zaheer (1999) go on arguing that establishing and maintaining legitimacy will be easier for MNEs with a geocentric or polycentric orientation than for MNEs with an ethnocentric orientation. L’Oreal promotes a global image of itself, but is often adopting a polycentric approach in marketing the same products in different geographical regions. Therefore, L’Oreal shouldn’t face legitimacy problems in terms of organizational complexity. However, L’Oreal is likely to experience problems in the legitimation process.

First of all, “ Larger and more visible MNEs and their subunits will find it a greater challenge than will smaller and less visible MNEs and their subunits to maintain legitimacy, because they are more vulnerable to attacks from interest groups. ” (Kostova ; Zaheer, 1999). Due to L’Oreal’s sheer size, it can reasonably expect to be exposed to such attacks on a regular basis. These attacks may come from the side of competitors, but also from interest groups which seize the possibility to make publicity for themselves at the expense of L’Oreal’s image. Furthermore, when the MNE as a whole or any of its subunits experience legitimacy problems, this will have a negative impact on a MNE subunit to establish and maintain legitimacy (Kostova ; Zaheer, 1999). This seems to be the case with L’Oreal, as it does experience public doubt in its ethics in its skincare businesses (Appendix: Ethiscore).

Since Lumae is also a skincare product, albeit a drinkable one, the bad ethical image of L’Oreal’s skincare businesses may spill over on Lumae and impact its sales negatively. This is further aggravated, if we assume that people generally are conscious about what they eat and drink. Managerial Recommendations: In order to take full advantage of the benefits that the new industry offers, L’Oreal should reallocate considerable resources to it.

For now, as Lumae is only in its development phase, it can be regarded as a 'Question Mark' according to the BCG Matrix (Appendix: The BCG Growth-Share Matrix). Therefore L'Oreal should identify its brands that can be considered as 'Cash Cows', and have them support Lumae as it will enter a rapidly growing market. The purpose is to turn Lumae into a 'Star'.

Moreover, in order to minimize the legitimacy problems, L'Oreal should be transparent to the public in terms of the ethical production processes of Lumae. Also, not to put its image into jeopardy, L'Oreal should not overstate the skin caring abilities of Lumae, in order to establish a strong credibility as an ethical company adhering to the principles of Corporate Social Responsibility. .