Global Marketing

Contemporary theory, practice and cases

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Chapter 5

International Market Planning

Learning objectives

After reading this chapter you should be able to:

- Understand what motivates a firm to expand abroad rather than in its domestic market.
- Identify the drivers of international market expansion.
- Understand measures of competitiveness
- Understand the fundamentals of internationalization theories.
- Apply theories of internationalization to case studies of business firms.
- Know more about “born global firms“ and why they are different from traditional players
- Realize that there are many indicators that can be used to evaluate market attractiveness

Internationalization

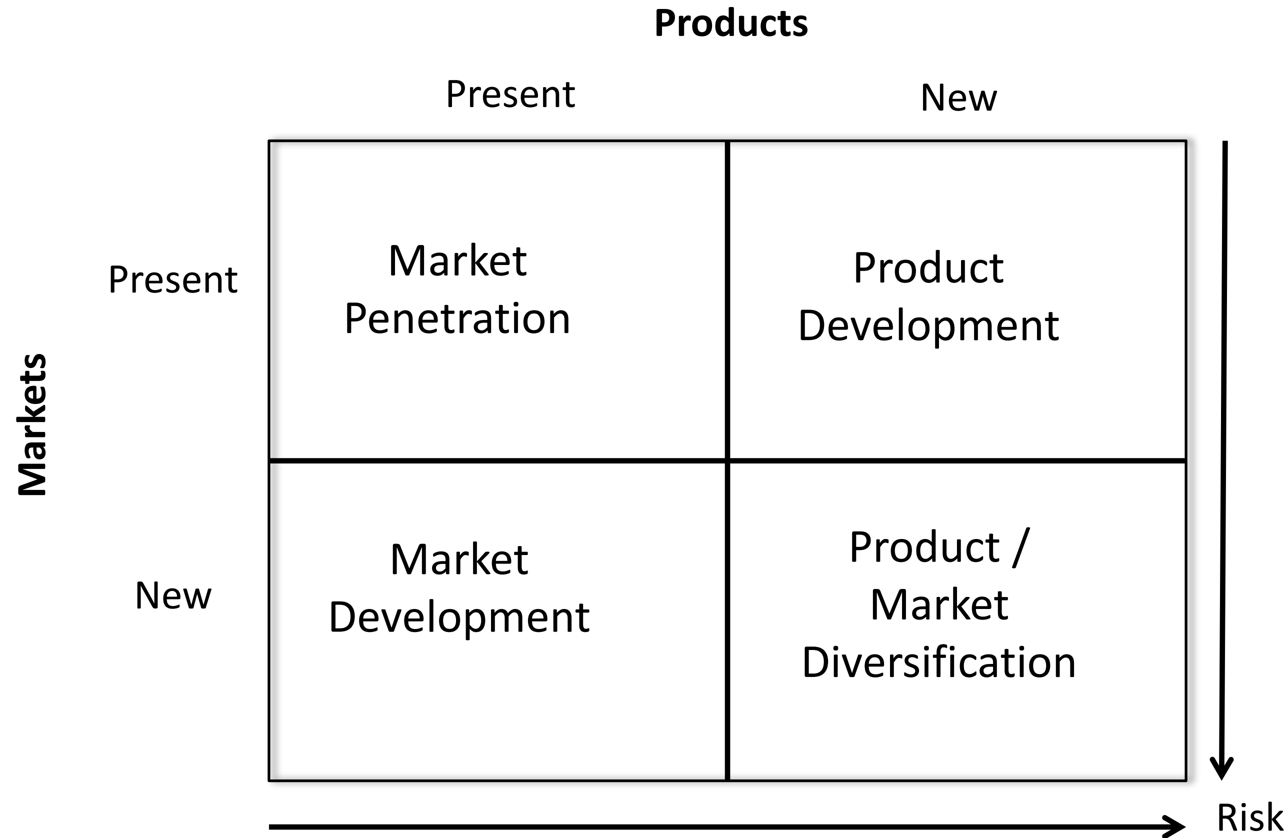
INTERNATIONALIZATION: occurs when a firm makes a strategic decision to enter foreign markets and adapts its operations to international environments by committing both tangible and intangible assets, experiential knowledge, learning, and human resources to this effort.

MOTIVATION FOR INTERNAL (domestic) vs. EXTERNAL (foreign) EXPANSION

Example: ESTEE’ LAUDER

Estée Lauder is focusing on cities with the biggest growth potential.
After decades of doing business in South Africa and its neighboring countries, in 2014, the company operates in a total of 14 markets on the continent.

The ANSOFF EXPANSION MODEL



Source: Adapted from: Igor Ansoff, "The Firm of the Future," Harvard Business Review, September–October 1965.

ANSOFF STRATEGIES

1. **Present markets/present products:** gain higher market share in existing markets using existing products. More resources are dedicated to marketing offering price discounts and better relationship with customers.
2. **Present markets/new products:** new products to current markets. It requires developing or acquiring new products or line expansion. These products need to be accepted by consumers and should not be too far away from the branding of the original product because this is what has created the product image in the past.
3. **New markets/present products:** New markets may be solely domestic or both domestic and global.
4. **New markets/new products:** With the increasing interest in emerging markets, companies have begun to target the specific needs of the emerging consumer. This strategy may not only result in new products for developed markets but may also benefit developed countries these innovations can be transferred back to. Companies now begin with their experience and knowledge of their customers in distant markets and use information to conceive, design and make a new, locally appropriate product from the ground up.

Motivation to internationalize: proactive and reactive (1)

PROACTIVE MOTIVES: stem from management's beliefs that internationalization improves the current position of the firm.

For instance, four **main intentions** drive Chinese companies to go abroad:

1) securing natural resources,
2) gaining access to new markets
3) buying strategic assets
4) improving domestic and overseas efficiency.

Trade agreements are also motives for internationalization. An agreement that serves to reduce trade barriers will certainly encourage domestic firms to take advantage of lower tariffs in order to export.

State Owned Enterprises (SOEs)	Non-State Owned Enterprises (SOEs)
Natural resource seeking	Strategic asset seeking
Increasing international competitiveness	Access to new markets
Maintaining domestic leading position	Seeking technologies
	Diversification
	Seeking efficiency

Motivation to internationalize: proactive and reactive (2)

REACTIVE MOTIVES: Reactive motivated firms view internationalization as a **necessary response** to unfavorable conditions in their current markets. Such conditions may be increased competitive pressures, excess capacity given domestic market conditions, a declining domestic market or saturation of the home market. There is some evidence to show that **firms that engage in proactive planning are more successful than those that do not (reactive)**.

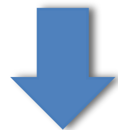
A comparison between different international sports wear companies and their internationalization strategies:

	LiNing	Adidas	Nike
Foundation Date	1990	1949	1971
Employees (2013)	3,592	50,728	48,000
Revenues (2013) -US$	948.9 million	15.88 billion	25.3 billion
First Internationalization	2001 : Spain	1950 : First exports to Switzerland, Scandinavia, and Canada	1972: Canada; 1974: Australia
Internationalization Motive	Creation of trends and enhancement of the brand	Ensure future growth	Cost effective production

Theories of internationalization and market entry

The criteria for determining whether to expand in an internal, rather than a foreign market, are based on the transaction costs of information, opportunism and asset specificity.

Cost of information acquisition in foreign markets is far more expensive than acquiring information in internal markets.



If transaction costs of operating abroad are higher they cause market failure and serve as a barrier to internationalizing the firm.

Internalization theorists suggest that foreign direct investment occurs when the benefits of internalization outweigh its costs.

Different approaches for internationalization

Theoretical Perspective	Main Author(s) / Year	Focus
OLI Model	Dunning (1981, 1988, 2006)	• Inside-out oriented asset exploitation. Modified OLI-paradigm with inward investment and more collaborative linkages
Incremental Process Theory (Uppsala Model)	Johanson and Vahlne (1977), (2009) (2013)	• Inside-out orientation built on substantial home advantage as an antecedent to internationalization, sequential market entry • Later focus on relationships, which connects to network approach
Network Approach	Johanson & Mattson (1988)	• Internationalization occurs within the network by making use of existing information and resource exchanges
Transaction Cost Analysis	Hirsch (1976)	• Internationalization is linked to the costs that occur in dealing with specific entry mode options
Linkage, Leverage, Learning Model	Mathews (2006)	• Outside-in orientation with latecomer firms using overseas investments and global linkages to leverage their existing cost advantages and learn about new sources of competitive advantage
International New Venture Theory	Oviatt & McDougall (1994); Jones & Coviello (2005)	• Internationalization starts right after foundation by ignoring psychic and cultural distance

OLI Model

Entry mode decisions are based on three conditions or advantages:

1. **Ownership** (who is going to produce abroad),
2. **Location** (where to produce)
3. **Internalization** (why to produce rather than license someone else)

Foreign direct investment (FDI) will be the preferred mode when three conditions are fulfilled:

- The firm must have net ownership advantages over competing firms.
- It must be more profitable for the firm possessing these unique assets to use them itself rather than transfer the rights to others
- It must be advantageous for the firm to exploit its unique assets through production outside its home country rather than by exporting.

Critique:

- In the framework, location advantages are treated independently from ownership advantages. However, there is a constant **interplay between O, L, and I** that the model doesn't take into account
- Further, the model is **mainly valid for Western firms but may not be able to explain the reality of emerging market firms (EMFs)**, which tend to internationalize even if they do not necessarily have unique ownership advantages based on superior technology, competitive products, or management know-how.

Uppsala model

Explain the sequential steps in the direction of increased foreign dedication.

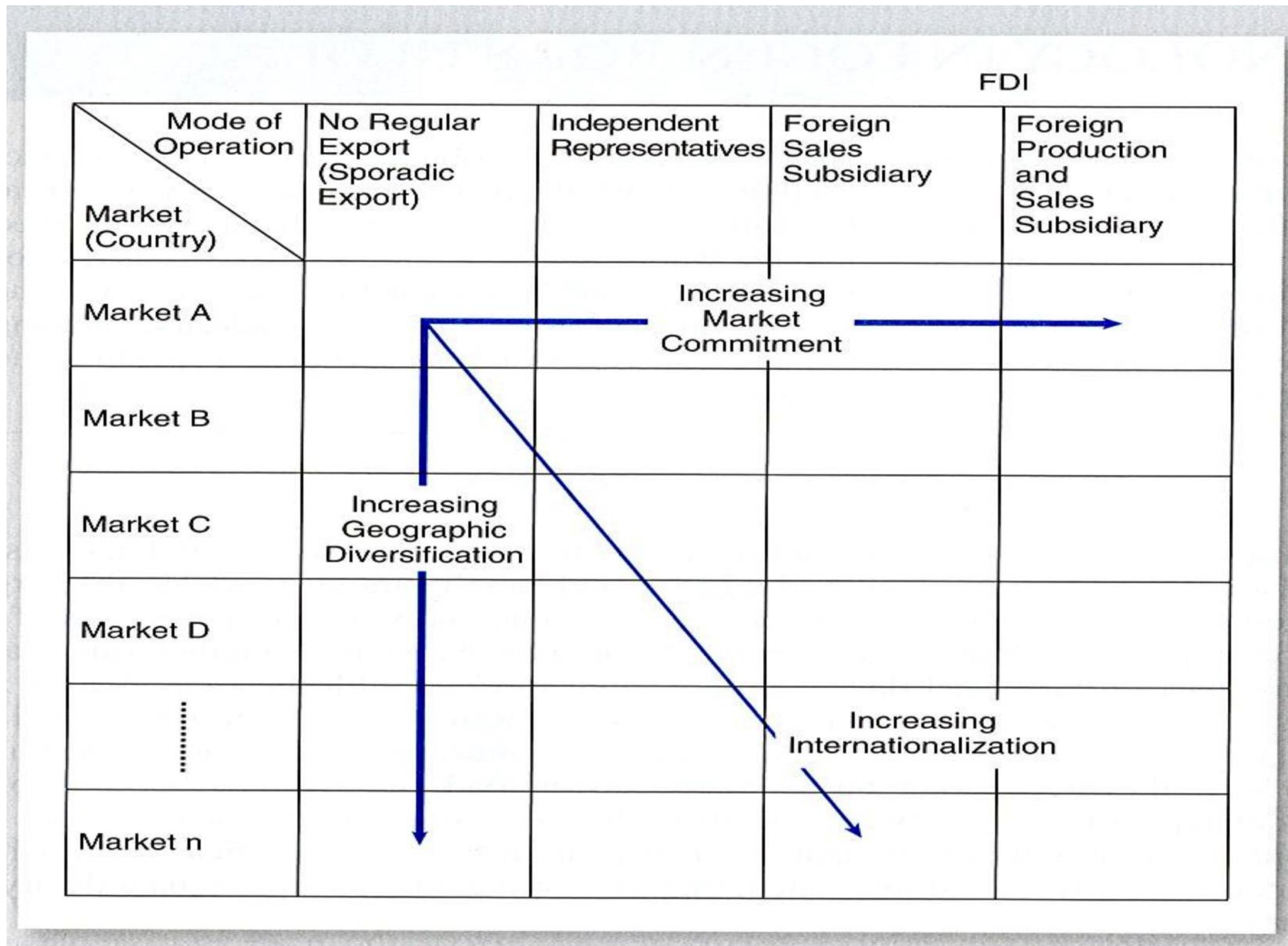
Over time, firms gradually progress through **a series of stages based on experiential learning and commitment of resources**.

1. In the first stage there are only sporadic exports, mostly from unsolicited orders.
2. Regular exporting is accomplished in the second stage, via contracts with established, independent distributors and sales representatives abroad.
3. In the third stage, a foreign sales subsidiary is organized.
4. In the fourth stage, a manufacturing subsidiary is established.

Firms first enter into markets that are psychically close to their home base and later enter more distant markets as their experiential knowledge increases.

Critique: acquisition of knowledge is faster than indicated by the stage model

Uppsala model



Sources: Adapted from: Forsgren, M., & Johanson, J. (1975). *Internationell företagsekonomi (International business economics).* Stockholm: Norstedts; Dervilée, F., Rieche, M., & Zieske, A. (2004). *Internationalization and foreign market entry choice: An alternative approach to the Kristianstad 30 Model* [MBA thesis]. Högskolan: Kristianstad.

Uppsala model: critiques

- **Why can't firms leapfrog stages?**
  - Acquisition of knowledge is faster than indicated by the stage model.
  - Knowledge may be acquired by hiring experienced international managers, by attending seminars sponsored by export institutes and from consulting organizations.
  - The world has become flat and integrated, facilitated by rapid dissemination of information.
- The model is **uni-directional**; it does not consider the possibilities of changing strategies at a given stage, e.g. divestment or choosing a cooperative mode such as a strategic alliance.
- Especially **born global firms** show a totally different internationalization behavior which opposes the insights of the Uppsala model
- If companies sell **products with a short life-cycle**, incremental market entry may not be the optimum solution because the time available for return on investment is short and entering foreign markets in an accelerated way may be preferable.
- **Later developments of the theory** have taken some of these aspects into account, for instance, by emphasizing the importance of **network relations**, the **role of uncertainty**, and a more dynamic perspective by emphasizing opportunity **development capabilities**, **internationalization capabilities**, and **relational capabilities** that all support the manner and extend of a firm's venturing abroad.

Network approach

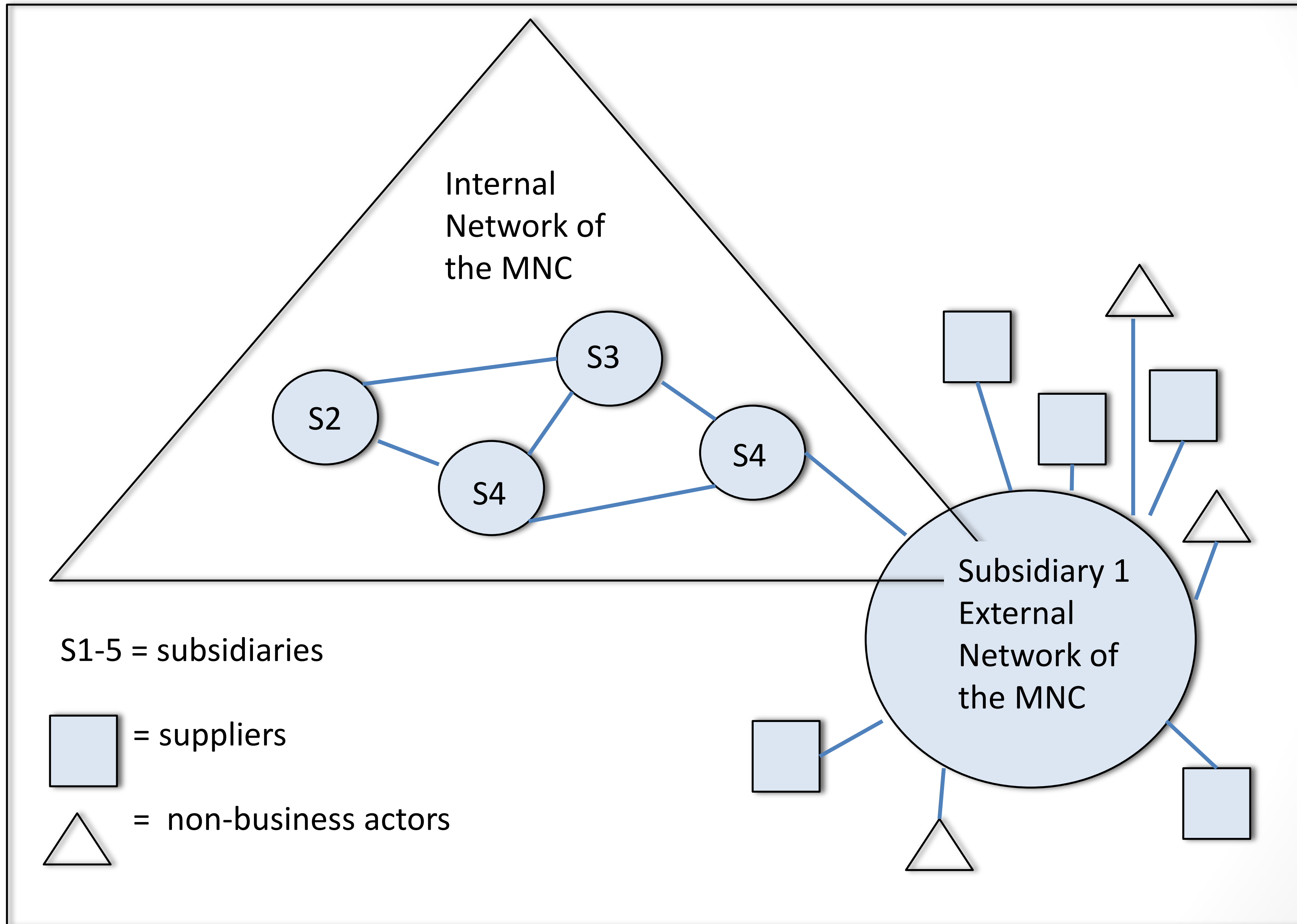
All different forms of networks have in common that they require **complex strategies** to ensure their viability and success.

- An **industrial network** normally includes different players involved in production, distribution, and usage of services and products.
- **Financial networks** are important for SMEs since these companies normally need to finance their expansion with external capital.

Network participants are governed by exchange relationships rather than through the market. Because many small companies do not have infinite resources, network collaborations are seen as an important internationalization strategy.

Network-based relationships	Market-based relationships
Shared Knowledge	Knowledge Serves Competitive Advantage
Interdependent	Independent
Consent	Contracts
Trust	Price
Learning	Power
Partners	Customers
Scandinavia	UK, US, Australia

A Multinational Firm's Network: an example



Transaction cost approach

A **transaction cost** is a cost of making an economic exchange. There are three sorts of costs:

a. Search and information costs
b. Bargaining costs
c. Monitoring (governance) costs

We can discern at least three scenarios of transaction costs by mode of entry:

1. **Production at home for export** involves local manufacturing costs, search and bargaining costs for distributors, and governance costs.

2. **Licensing** includes search and bargaining costs for a licensee, governance costs, and the risk of dissemination.

3. **Production abroad** involves manufacturing costs in the foreign country, possible bargaining costs if the subsidiary is not wholly owned, and some governance costs.

Transaction cost approach

According to transaction cost theory, **a firm will tend to export or license when transaction costs are low or shift production abroad when transaction costs are high**.

Producing at home for export determines:

1. Domestic production costs (Pd)
2. Export marketing costs (Md)
3. Domestic governance costs (Cd)

Producing abroad incurs costs of:

1. Foreign production (Pf)
2. Local marketing (Mf)
3. Foreign governance (Cf)

$$Pd + Md + Cd < \geq Pf + Mf + Cf$$

$$Pd < \geq Pf + \underbrace{Mf - Md} + \underbrace{Cf - Cd}$$

The difference between export marketing and domestic marketing costs (M) is defined as **M = Mf – Md**
The difference between foreign and domestic governance costs (C) is defined as **C = Cf – Cd**

The decision to export or produce abroad (FDI) is determined as:

If Pd < Pf + M + C, then export

If Pd ≥ Pf + M + C, then FDI

Transaction cost approach: critiques

- Transaction cost theory assumes that **exporting and production are substitutes**. In reality there are many examples where a firm both manufacturers abroad *and* exports from its home market, as well.
- A firm may **invest abroad in order to gain raw materials or know-how** that are not available at home. This behavior is not explained by transaction costs.
- It is **difficult to measure transaction costs**, especially in advance of choosing an entry mode.
- **Small and medium enterprises (SMEs)** tend to reflexively rely on non-equity modes of entry (exporting, licensing, etc.) because they would rather preserve capital and avoid high risks when moving into international markets. SMEs can evaluate three specific transaction cost criteria:
  - Level of investment required for each asset.
  - Environmental factors of the target country
  - Status of internal control systems and processes.

Linkage – Learning - Leverage model (LLL-model)

The LLL-model emphasizes that linking to foreign partners and building corporate capabilities by exploring external assets may greatly improve a firm's market position at home.

- **Linkage:** Firms use joint ventures and partnerships to internationalize new knowledge, which is a lot quicker than building their own subsidiaries in the foreign country.
- **Learning:** may involve both cost-based efficiency improvement and operations as well as learning about technologies, brands, marketing and management issues, which is most often the predominant objective.
- **Leverage:** means that knowledge acquired abroad can transferred back home and used to improve competitiveness in the local market.

Critique: linkages that imply loose forms of collaboration may no longer be the preferred option to obtain knowledge and increase technological quality.

Chinese car makers trying to catch up

International New Venture Theory

This new stream of research started from the definition of international new ventures as:

- **business organizations** that, from inception, derive their competitive advantage from the **use of resources and the sale of output in multiple countries**;
- "**born globals**", defined as firms that have reached at least 25% of foreign sales within three years after establishment.

- As they are young, small in size, they have an entrepreneurial orientation, and do not have the hierarchical structures established, which we often find in larger organizations, they exhibit **more flexibility and can thus more easily adapt to changes**.
- These firms possess a **strong international marketing orientation and competency** that allows them to focus intensely on the needs of customers in each new market and deliver high-quality, unique products.

Critique: internationalizing at an earlier stage involves more risk-taking than the well-established internationalization processes of older firms.

Patterns of internationalization

Incremental Internationalization	New Venture Internationalization
Major Driving Forces: Control, uncertainty avoidance, risk reduction. Internationalization is a process built upon knowledge accumulation and experience	**Major Driving Force**: Discovery and innovation : accelerated internationalization in new and unknown territories is based on the development of hitherto non-existing capabilities.
Theoretical Model: Uppsala (Johanson & Vahlne, 1977, 1990)	**Theoretical Model**: The New Venture theory (Oviatt & McDougall, 1994)
Process: path dependent and incremental stages of internationalization. Slow and regular process with a limited number of targeted countries. Increasing commitment to foreign markets.	**Process**: Speed, irregularity, geographic dispersion. Focus on the role of entrepreneurs. Risk-taking posture and international experiences encourage rapid internationalization at a young age.

Different internationalization patterns

Source: Adapted from: Verdier, S., Prange, C., Atamer, T., & Monin, P. (2010). Internationalization Performance Revisited – The Impact of Age and Speed on Sales Growth, *Management International*, 15(1): 19-31.

Speed of internationalization

Internationalization processes can be distinguished according to the time elapsed until a firm starts international activities, i.e., **internationalization age** and further to the **speed of internationalization**. Differences in these two parameters suggest new ways of accounting for different internationalization processes that are likely to entail **performance differentials**.

		Internationalization Speed	
		Slow	Fast
Internationalization Age	Young	Case 1 – Aldi (7 years old, 0.84 % internationalization speed)	Case 2 - International New Venture Theory - Metro (5 years old, 1.16 % internationalization speed)
	Mature	Case 3 – The Uppsala Model Tesco (74 years old, 0.34 % internationalization speed)	Case 4 – Casino (87 years old, 4.33 % internationalization speed)

Source: Adapted from: Verdier, S., Prange, C., Atamer, T., & Monin, P. (2010). Internationalization Performance Revisited – The Impact of Age and Speed on Sales Growth, *Management International*, 15(1): 19-31.

- Speed is considered a time-based measure representing how fast a firm develops outlets abroad, changes in the ratio of foreign entities to total entities.
- Slow internationalizers are firms that choose a gradual process with a low increase in the ratio of foreign stores to total stores during our period of observation.

Measures of internationalization and competitiveness

INTERNATIONALIZATION PERFORMANCE:

- **FTSE:** foreign sales to total sales
- **FATA:** foreign assets to total assets

PROFIT vs. GROWTH:

- Growth typically involves huge investments.
- Profit-oriented survival strategies imply that investments into new market creation will be limited: it is the case when firms prefer to penetrate existing markets and/or expand only into a small number of foreign markets to avoid uncertainty and decrease operational risks stemming from multiple market entry.

Concentration Ratios: HERFINDAHL-HIRSCHMAN INDEX (HHI)

It is a commonly accepted measure of market concentration.

It is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers.

The HHI number can range from close to zero to 10,000. The HHI is expressed as:

HHI = s1^2 + s2^2 + s3^2 + ... + sn^2 (where sn is the market share of the ith firm).

- The closer a market is to being a **monopoly**, the higher the market's concentration. If, for example, there were only one firm in an industry, that firm would have 100% market share, and the HHI would equal 10,000 (100^2), indicating a monopoly.

- Or, if there were thousands of firms competing, each would have nearly 0% market share, and the HHI would be close to zero, indicating **nearly perfect competition**.

Concentration Ratios: C-RATIO

The concentration ratio is the percentage of market share held by the largest firms (m) in an industry and can be expressed as CRm.

The concentration ratio can be express as:

CRm= s1 + s2 + s3 + … … + sm (where si=market share of the i firm)

- If the CR4 were close to zero, this value would indicate an extremely competitive industry since the four largest firms would not have any significant market share.
- In general, if the **CR4 measure is less than about 40**, then the industry is considered to be very competitive
- On the other extreme, if the **CR1 measure is more than about 90**, meaning that one firm controls more than 90% of the market, this is effectively a monopoly.

Discussion questions

1. Why does the LLL-model explain emerging market firms' internationalization behavior so well?
2. Can the Uppsala Model explain the actions of large MNCs?
3. How can a manager make use of the eclectic decision framework?
4. What are the advantages of a born global firm as opposed to a large multinational company.
5. How can you use the HH-index to determine market entry?