Advanced Diploma

in

Business Administration

Study Manual

INTERNATIONAL BUSINESS (CASE STUDY)

The Association of Business Executives

William House • 14 Worple Road • Wimbledon • London • SW19 4DD • United Kingdom
Tel: + 44(0)20 8879 1973 • Fax: + 44(0)20 8946 7153
E-mail: info@abeuk.com • www.abeuk.com

ABE Advanced Diploma in Business Administration

Study Manual

INTERNATIONAL BUSINESS (CASE STUDY)

Contents

Advanced Diploma in Business Administration

International Business

Syllabus

Aims

1. Appreciate that many businesses are no longer operating in the domestic local environment.
2. Develop a sense of urgency that tremendous opportunities exist to develop business if companies can change their mind-sets from domestic to international dimensions.
3. Acquire the expertise to develop strategies for international expansion and, in so doing, to understand how to deal successfully with a range of business issues at an international level.

Programme Content and Learning Objectives

After completing the programme, the student should be able to:

1. Understand the key questions posed by international business and global operations, and be aware of the main reasons why businesses develop internationally.
2. Define globalisation and, in understanding what it means, appreciate how it impacts on all functions of the business.
3. Understand the changing nature of the international business environment with specific regard to:
   - The macro factors that underpin world trade. These are the powerhouses that drive changes in patterns of behaviour;
   - The major international bodies, IMF, WTO, World Bank, etc., and their influences on shaping the liberalisation of world trade.
4. Understand the factors that give rise to different behaviour patterns (both buying behaviour and other organisational behaviour) in different countries including culture, stages of economic growth and local environmental conditions. Appreciate a range of cultural factors which impinge on firms doing business in overseas settings.
5. Recognise the strategic role of information gathering in directing international business decisions and be aware of the issues surrounding information gathering in an international environment.
6. Recognise the changing planning framework as companies deepen their international and global commitments, and their impact on production, finance, operations, marketing and human resource management.
7. Understand the implications of international operations for distribution and logistics within the firm.
8. Understand the human resource management implications of operating on an international scale.

9. Appreciate the range of alternative means by which international market entry may be achieved and the organisational and financial implications of each.
10. Have a clear grasp of the range of tools of the marketing mix in differing economic, political and cultural situations.

Method of Assessment

By written examination. The pass mark is 40%. Time allowed 3 hours.

The question paper will contain:

Three compulsory questions. All questions may carry different marks.

Notes about the Examination

A case study will be provided to candidates which they will be expected to analyse prior to the examination. Candidates will be required to demonstrate their analytical ability with reference to the strategic concerns and issues raised by the case study and to make strategic recommendations based on the outcomes of their analysis.

This is an open book examination and you may bring in any material in the form of books or notes to help you answer the set questions. However, you must not hand in any prepared material as this will not be marked by the examiner.

Dealing with a case study of this type is quite a complex task and it is strongly recommended that you familarise yourself with the techniques and approaches to analysis required. The reading list below suggests one publication which provides such guidance.

Notes about Studying this Subject

In answering questions in the examination, you will be expected to draw on and apply concepts, knowledge and skills acquired in ***all*** Advanced Diploma subjects. In studying the course materials for this subject, therefore, you should constantly be thinking of the application of your studies in the other subjects to the international issues and context under discussion.

In addition, it is important that you are aware of, and able to assess, the implications of recent developments and events in respect of their effect on international business. Of particular relevance here are developments in the contribution of the Internet and the rise of e-commerce, in the introduction of the Euro and in the implications of international terrorism.

Further Reading

The ABE is keen to encourage students to read around their subjects although your study manual provides complete coverage of the syllabus for the examination. If you have time available once you have worked through the manual, you may wish to consult one or more relevant books from the ABE's suggested reading list which can be found in each subject syllabus. Advanced Diploma students especially should supplement their study of the manual with wide reading of relevant journals, quality newspapers and contemporary media sources.

Recommended Reading

- C Hill, *International Business – Competing in a Global Market Place*; 3rd edition, 1999 (McGraw-Hill)
- CIM Tutorial Text 2001/2, *Strategic Marketing Management: Analysis and Decision*; BPP

  Note that, whilst this publication is designed for a course which has a very similar case study approach (one of the Chartered Institute of Marketing's Diploma subjects), the subject matter for this subject is different. You will need to keep your focus on international business as you work through the techniques and approaches which are discussed.

Additional Reading

- K Lewis, & M Housden, *An Introduction to International Marketing – A Guide to Going Global*; 1998 (Kogan Page)
- P Fifield, & K Lewis, *International Marketing Strategy*; 4th edition, 1999 (Butterworth Heinemann)

Study Unit 1

The Importance and Nature of International Business

Contents ***Page***

INTRODUCTION

Fewer and fewer companies these days can focus only on their domestic markets. Increasingly, businesses need to understand, consider and plan for international markets. The growth of international business, in all its facets, represents probably one of the most significant commercial developments in recent years. Specifically, international markets represent one of the most significant sources of business opportunities (and threats).

Just consider for a moment some of the following facts:

- Initial forecasts of world trade in the year 2000 suggest that the total value of goods and services traded will reach nearly $7 trillion.
- China alone represents a total potential market of some 6 billion people.
- Approximately $1 trillion crosses national boundaries each and every day.
- The world's largest 500 companies derive on average approximately 70% of their sales and profits from international markets.

Small wonder then that international business opens up such major profit and sales opportunities to companies. Moreover, virtually every available measure indicates that international, as opposed to purely domestic, business has for many years now been the fastest growing area of commercial and trading activity and that, if anything, this growth is set to accelerate into the future.

The bald statistics on the importance and growth of international marketing, impressive though they may be, do not of themselves tell us about the following issues:

- The reasons for this growth.
- The nature and variety of international business activities.
- How, if at all, international business differs over and above purely domestic business.
- Related to the above, the implications of any differences for the financial, marketing and operations managers and in particular what additional skills and techniques are required when planning international business strategies.
- The key trends and developments in the scope and nature of international business and the way that international markets and business are likely to develop in the future.

As a prelude to understanding how to analyse international markets and to develop and implement business strategies for them, we need first to understand some of the background to the nature, growth and scope of international business. This first study unit is designed to do this.

A. THE IMPORTANCE AND GROWTH OF INTERNATIONAL BUSINESS

As already indicated in the introduction, international markets represent one of the largest and fastest growing areas of commercial and marketing activity. As such, they represents one of the most significant areas of business opportunities for the organisation. A number of factors serve to underpin the size and growth of international activities, some of the most important of which are considered below.

The Changing Nature of the International Business Environment

As in all business situations, opportunities and threats stem from changes in the environment. In environments which are not dynamic and changing, few such opportunities and threats arise. There is little doubt that the international environment is one of the most dynamic. It is this dynamic nature which gives rise to major opportunities for international business.

Examples of some of the major changes in the international business environment in recent years include the following:

- The growth of whole new trading blocs and major changes to existing ones, e.g. the expansion of the European Union (EU), the formation of the Association of South East Asian Nations (ASEAN) and the Andean Common Market (ANCOM).
- Newly emerging markets with significant growth potential, e.g. the Chinese Economic Area, Indonesia, India, South Korea and Mexico.
- Fundamental changes to the economic systems in some countries/regions of the world, for example the collapse of the former Eastern European Communist Bloc.
- Diminishing barriers to international trade and consequent significantly increased competition across national boundaries and often, as we shall see later, on a global basis.
- The growth of the multinational and transnational organisation.
- The development and impact of the Internet

These, and other changes, are in fact considered in more depth in this and later study units, but at this stage it is sufficient to note that it is the particularly dynamic nature of the international environment which provides the source of major business opportunities.

(a) The continued liberalisation of international trade

This particular aspect of the international environment is of particular importance when considering the growth of international business. As already indicated, there has been a continuing trend towards the liberalisation of international trade. Starting after the Second World War, under the auspices of GATT (latterly the World Trade Organisation), agreements have been reached to gradually remove trade barriers such as tariffs and quotas. Imperfect though these agreements have sometimes been, there is no doubt that these have helped the growth of world trade and the rising importance of international business. Patterns of world trade and understanding the world trading environment are so important to international business that we consider them in more depth again in Study Unit 3, together with the social, legal, economic, political, technological and competitive forces which underpin them and which are considered in Study Unit 4.

(b) Cosmopolitan customers

A third factor in the growth in importance of international business is the changing nature of customers and demand, and in particular, the increasingly cosmopolitan nature of today's customers.

Today's consumer is much more widely travelled compared to even a decade ago. Combined with an increasingly global media network, today's consumer is exposed to global lifestyles, products and brands. Increased affluence and education on the part of customers have also served to reinforce much more cosmopolitan attitudes and lifestyles. At the turn of the twentieth century, our grandparents were mainly exposed to domestic products and services. Furthermore, they weren't particularly interested in buying "foreign" products. Today's consumer, however, travels widely and wants to purchase the best value and most innovatory products and services, regardless of their country of origin. Clearly, consumers and their needs change, together with their buying habits and the influences on these.

Understanding the consumer and their needs lies at the heart of business strategy and planning. This is no different in international business – indeed, if anything, one might argue that the need to understand or at least analyse customer behaviour is heightened when considering consumers across international frontiers. For this reason, therefore, we consider the importance of understanding customer behaviour in Study Unit 5.

(c) Improved communications

Helping to facilitate the emergence of the more cosmopolitan international consumer have been the huge improvements in international communication. Indeed, the increase in international travel just referred to has partly come about because of these. So, for example, it now costs approximately 1/6th in real terms of what it did only 15 years ago to fly the Atlantic. Of particular importance in this area, of course, has been the growth of new communication technologies such as satellite TV and more recently the growth of the Internet which is rapidly becoming ubiquitous and is giving ready access to consumers to international trends and markets.

(d) Strategic networking and the international supply chain

It is not only final customers that have become more cosmopolitan in their lifestyles and purchasing habits, but so too have organisational customers.

- ***Strategic networking*** is the formation of alliances and agreements between companies. Such alliances and agreements may involve, for example, licensing, franchising and even mergers and acquisitions. Strategic networking is an attempt to combine two or more companies' skills and resources so as to be able to compete better.
- ***International supply chains*** refers to the increasingly international nature of supply in as much as companies often purchase components, raw materials, services, etc. from very diverse parts of the world

Increasingly, organisational buyers, whether in manufacturing, services or retailing, are looking towards non-domestic suppliers to provide their raw materials, components and finished products. A good example is that of the United Kingdom retailer, Marks & Spencer. At one time, Marks & Spencer made a feature out of sourcing from only UK suppliers wherever possible. However, in recent years this company, facing increrasingly aggressive competition, has begun to purchase from whichever supplier can best serve their needs with regard to factors such as price, design, delivery and so on, irrespective of their geographical location in the world.

Some of the same factors underpinning the emergence of the more cosmopolitan consumer, such as improved communication and so on, apply equally to the organisational customer. In addition, however, companies are increasingly developing strategic networks with suppliers which are based on international supply chains. So, for example, a car which is ultimately sold in the United Kingdom may have had its engine built in Spain, its transmission in Japan, its gearbox and steering in Korea and its trim in Brazil, with assembly in Germany.

A number of factors underpin this growth of strategic networking and international supply chains. So, for example, increasingly, even the largest companies can no longer afford to develop new products on their own, but must share the risk by developing strategic alliances with other companies, often in different parts of the world. Similarly, sometimes a company will be unable to gain access to an overseas market without the help of a local company and so again, strategic alliances or joint ventures of some kind are increasingly the order of the day. One of the most significant developments promoting the growth of the international supply chain has been the recognition that managing supply effectively through value chain activities can be one of the most important sources of competitive advantage. There is no doubt that strategic networking and the international supply chain management which is associated with this, will continue to facilitate the growth of international business in the future.

(e) Growth of global companies – multinationals and transnationals

Factors already discussed which have served to underpin the growth of importance of international business have in turn led to the emergence of the global company.

The global company thinks, plans and operates on a truly global basis; in other words, it transcends international boundaries. The 1980s and 1990s have seen the emergence of the multinational and, more recently, transnational company. In an admittedly somewhat chicken and egg fashion, the emergence of the global company has in turn helped fuel further growth in international business. At this stage, we should note that one factor in particular linking the global company with the growth of international business itself has been the growth of the global brands which such companies have promoted.

(f) Global brands

A combination of increasingly cosmopolitan consumers and lifestyles, together with the growth of global companies, have led to the growth of the global brand. Global brands transcend international boundaries and include brands such as Coca Cola, Ford, Mercedes, IBM and Rolex, to name just a few examples. Global brands reduce the risks for customers of buying brands produced in other countries. They also help facilitate a feeling of “belonging” on the part of customers throughout the world with shared lifestyles, values, aspirations, etc.

These, then, are just some of the key factors which underpin the growth in, and importance of, international business. Again, remember that we will be considering many of these factors again in more depth in later study units. Here, we are simply concerned to establish the importance of international business and the fact that the dynamic environment which surrounds this area of business means that this is an area of significant opportunities. Needless to say, to recognise and appraise these opportunities is a key part of the international business’s task. In addition to understanding the nature of the international environment and the factors which underpin this, including competitor and customer aspects, the international business also needs to understand and be able to apply the tools of international marketing research together with the concepts and techniques of competitive, absolute and comparative analysis. These two aspects of appraising international marketing opportunities, therefore, form the focus of Study Units 6 and 7 respectively. But what

prompts companies to consider "going international" in the first place? What are some of the key motives and incentives?

Reasons for Going International

All business is ultimately about identifying opportunities in markets and developing programmes to take advantage of these. We have already discussed some of the reasons for the growth of international business which have served to illustrate how dynamic this area is and therefore how it gives rise to significant opportunities. In broad terms, going international offers several potential advantages over and above purely domestic markets. For example, we have already seen that international markets and trade have tended to grow faster than more domestic economies.

Furthermore, there is substantial evidence to suggest that international markets and business are more profitable – i.e. the companies that operate in these markets achieve higher rates of return than their purely domestic counterparts of a similar size. It is not difficult to think of reasons for these higher rates of return. For example, international markets often give more scope for economies of scale or similarly, may allow the business to source components and raw materials, etc. more cost-effectively. Additionally, the international business may, through effective global branding, simply be able to command a price premium or gain leverage for shelf space in the retail outlet compared to the purely domestic counterpart.

There are all sorts of reasons, therefore, why international business may represent opportunities for increased profits but there are many reasons which may underpin a decision for a company to go international. Examples of some of these reasons are shown below.

(a) Saturated domestic markets – the international product lifecycle

Very often, the motive for going international by a company will be that its own domestic markets are saturated, with no potential for future growth. The business may therefore be prompted to look for other international markets where this potential still exists.

There may be several reasons why a market may be saturated at home and yet offer potential for growth in other markets, but one reason is the product lifecycle. You know, of course, that the product lifecycle concept illustrates the fact that products pass through a number of stages in their lives from introduction through growth to eventual saturation and decline. We can also see that a product may often be at different stages in different countries. So, for example, the microwave oven was entering maturity in the United States whilst at the same time only being at the introduction stage in the United Kingdom. Very often, in fact, there is a pecking order to the international product lifecycle with products and services first reaching maturity and decline in developed economies while still being at the growth or even introductory stage in developing economies. The point is that by carefully identifying the next growth market, a business can achieve a fresh impetus to growth when domestic markets have become saturated.

Three further examples of products which are at different stages of their lifecycle in different parts of the world are shown in the following table::

Product	Current stage UK	Stage of lifecycle elsewhere
Cable TV	Introduction/growth	Maturity (US)
Disposable nappies	Maturity	Introduction/growth (Poland)
Digital cameras	Introduction	Growth (Japan)

(b) Intense/increased international competition in home markets

Another factor which may prompt a company to go international is where it faces intense and/or increased competition in its domestic markets, particularly from non-domestic competitors. Sometimes the business may seek to avoid such intense competition by looking for non- domestic markets to maintain and expand sales and profits. The danger here, of course, is that competition will simply follow you into your new markets.

(c) An opportunity to exploit a real competitive advantage

A much more positive reason for going international than avoiding increased competition in the domestic market is where a company has a genuine competitive advantage which it wishes to exploit on an international basis. So, for example, a company with an innovatory new product which is, say, patent protected may feel that it wishes to gain the maximum value by expanding its sales of the product into other countries.

(d) Economies of scale

We have already mentioned the fact that international expansion through expanding the potential market often enables a company to achieve economies of scale. At one time, these economies of scale were linked to decreases in average cost in the production and research and development areas of the business, but increasingly, companies are also being driven by economies of scale in the marketing area and particularly in the areas of branding and advertising where going international can help reduce the average costs in this increasingly expensive area of the business.

(e) Merger and acquisition activity

Sometimes companies find themselves in the international arena through their merger and acquisition activities. Clearly, where the reason for the merger/acquisition is to, say, gain access to an overseas market, then obviously this is a conscious policy decision to go international. Sometimes, however, a company can find itself operating in international markets where the major reason for the merger/acquisition was perhaps to simply protect the domestic market or to acquire a valuable distribution structure. In doing so, however, the company may acquire/merge with a company that is already involved in international markets and so goes international by default.

Clearly, there are many reasons why companies go international, but it is important to stress that all the evidence suggests that where a company goes international for positive reasons it is much more likely to be successful. So, for example, a company that is experiencing difficulties in its domestic markets, such as decreasing sales, increased competition, etc. will often struggle if it attempts to move into international markets from this weak base.

This again highlights the importance of analysing and assessing international markets for genuine market opportunities and matching these opportunities to company competences and strengths. This aspect of identifying and appraising opportunities in international markets is again, I would stress, no different to purely domestic business. But if this aspect is no different, it raises the issue of what is involved in international business and it is to this area that we shall now turn our attention.

B. INTERNATIONAL AND DOMESTIC BUSINESS

Before considering the differences it might be useful, however, to consider what is similar in international and domestic business.

Similarities

(a) The centrality of the marketing concept

You will, of course, be familiar with the notion of the marketing concept, namely that effective business is based around identifying and satisfying customers' needs and wants. The importance of this concept is no different when considering international or domestic marketing activities.

(b) Management processes

The key processes of business management, too, are no different in international compared to domestic markets. Successful practice is still built upon the elements of analysis, planning, implementation and control.

(c) Management tools and techniques

All the tools and techniques pertinent to, and used in, domestic business activities are also relevant in the international context. So, for example, the tools and techniques of marketing research, market segmentation and targeting, forecasting and so on are just the same.

(d) The marketing mix

The elements of the marketing mix used in domestic marketing are all relevant to international marketing. So, later in the course we shall be looking at the 7P's of the marketing mix in the context of their application to international markets. Obviously, the application of the elements may differ compared to purely domestic marketing, but the ideas and concepts are just the same.

(e) Key decision areas/planning frameworks

Finally, the planning frameworks and key decision areas for international business are similar to those for domestic. So in marketing, for example, the business must establish objectives, select target markets and positioning strategies, develop marketing strategies encompassing the marketing mix and implement these and finally evaluate and control marketing activities.

As with the marketing mix, there will be some differences in application. So, for example, the business must decide the mode of entry into international markets – a decision obviously not found in purely domestic business, but again the principles and key areas of decisions are just the same in international, compared to domestic business.

Differences

With so many similarities between international and domestic business, what, if anything is different? The deceptively simple answer to this question (i.e. the key difference between international and domestic business) is the following:

"International business takes place across national boundaries."

At first sight, this would not appear to be a major difference but the very fact that international business is carried on across national boundaries is the reason for a range of major differences and applications of business concepts and techniques.

(a) Different environment, culture and language

Operating across national boundaries means that the business encounters a range of problems and issues not encountered when operating exclusively in domestic markets. Again, this deceptively simple statement masks the complexities and problems which this can cause. So, for example, the business must deal with a different set of environmental factors. Perhaps most significant of all, the business is dealing with a set of customers from a different culture and language.

So, for example, in respect of marketing, research involves considering language and respondent differences, and businesses must consider the extent to which marketing activities, and particularly the marketing mix, can be standardised across national boundaries.

(b) Customers

In advanced countries, the wide range of available goods and services leaves few unsatisfied market areas. Buyers can be very fickle about whether or not to buy, and businesses therefore must be very clear about identifying and satisfying customer needs.

In lesser developed countries, many customers have insufficient money to buy products. In other words, there is no "effective demand". However, people in these countries are often aware of the most up-to-date products through television and the cinema. Businesses in these countries face additional problems with regard to making products available which customers can afford.

(c) Market information and forecasting

International markets often exhibit very different rates of growth which, combined often with a paucity of information, makes it very difficult to develop reliable estimates of market size and sales forecasts.

(d) Competition

Businesses entering international markets, as already indicated, generally face much fiercer competition. Furthermore, this competition is now composed of perhaps unknown competitors from other countries. Admittedly, the purely domestic marketer can face international competition from both domestic and international competitors, but generally speaking, international business moves competitive pressures up to a new level.

(e) Environmental turbulence

Compared to domestic environments, the international environment within which businesses must operate is much more dynamic and unpredictable. Changes in the international environment can be very rapid indeed, such as the much discussed withdrawal of the UK and Italy from the Exchange Rate Mechanism of the European Union in September 1992. Even changes that have been expected for many years can be difficult to predict with regard to their impact and implications for business, for example the handing back to China of Hong Kong. Environmental factors such as inflation rates, disposable incomes and technological and legislative changes can all change very rapidly in international markets, making it much more difficult for business. On the other hand, as we shall see, this very dynamism in international markets also gives rise to major business opportunities.

C. TYPES OF INTERNATIONAL BUSINESS INVOLVEMENT

There are a number of different types of involvement in international business. At one extreme, some companies have a few sporadic foreign orders that they process as and when they arrive. At the other extreme, there are companies – such as Coca-Cola, Unilever, General Motors and Sony – with significant investments in plant, machinery and staff in other countries and with detailed marketing, planning and implementation in a large number of countries.

The degree of involvement can be measured by the percentage of sales revenue or profit contribution attributable to domestic and non-domestic sales. The amount of investment in non-domestic markets is another indicator. Other measures are the percentage of staff working on international markets and the relative planning importance given to international business.

The ways in which companies move from very little to intense international business have been explained in a number of different ways. In such a varied situation of companies, countries and interests, any one explanation is unlikely to be complete. Here we shall consider two such approaches.

Different Orientations, Different Management Culture

A widely used classification was developed by Howard Perlmutter to identify four different types of attitude or orientation that influence internationalisation. The orientations are as follows:

Orientation	Focus
Ethnocentric	home/domestic country
Polycentric	host country
Regiocentric	regional market groups, e.g. ASEAN
Geocentric	world/global

- The ***ethnocentric orientation*** is one where the attitudes and approaches of managements are based upon their own domestic market. Little or no consideration is given to the different needs of non-domestic customers.
- The ***polycentric orientation*** is associated with multi-national enterprises with subsidiaries strongly based in host countries. This orientation is sometimes called multi-domestic because the company operates with an almost domestic approach to a number of different markets.
- ***Regiocentric orientation*** has become more prevalent as regional market groupings have developed. In Europe we are seeing an increased interest in tackling European markets.
- ***Geocentric orientation*** is becoming increasingly important. It is sometimes mistakenly thought that the geocentric approach is only for very large companies. It is increasingly likely that all but the small companies will need to consider a geocentric orientation. Medium-sized companies might not compete in many markets around the world, but they need to be aware of emerging world trends in buying behaviour, in cost levels and in technologies. Without this global vision the company will not be able to adapt to our fast-changing world.

The Stages Approach

The following table illustrates the different stages a company may go through in developing from a purely domestic business to one that is fully international.

Table 1.1: The stages of international involvement

Stages in Process	Degree of International Involvement	International Business Approach
Domestic	None	None
Export selling	Reactive, very limited, experimental	None
Proactive exporting	Active involvement	Increasing knowledge and the development of planning approaches. Approaches are usually more tactical than strategic.
International	Committed involvement	The key here is that the company has some investment in at least one other country. Planning is used extensively, but usually on a multi-domestic basis.
Global	Committed strategic approach	Treats the ***world*** as an opportunity. The equidistant approach would be an ideal.

Note that the international business approach becomes more comprehensive, strategic and sophisticated the closer to the global stage the company has reached.

The difference between simply exporting and international business arises from the fact that exporting is the physical movement of a product produced in one country to another country. Profits are made from the sales revenue (less variable and indirect costs) gained from the non-domestic country customer. In international and global business, profits will be earned in a variety of ways:

- Net profits remitted by subsidiary companies;
- Net profits remitted from joint ventures;
- Licence fees earned by allowing non-domestic users to use your patented processes;
- Fees earned from the sales of "know-how";
- In addition, there will usually be sales revenues earned from exporting.

In general, international business is a more sophisticated process than exporting. It is usually closer to the final customer. Global business is a much more recent phenomenon. Whereas exporting and international business look for profitable opportunities, almost wherever they exist, global business seeks systematically to exploit opportunities around the world. For the global company the markets of Europe, North America and Japan, sometimes called the Triad, usually represent over 75% of the world market and are therefore of crucial importance. The Triad is likely to contain most of the world market and most of the world competition.

(a) The first steps in going international

Most companies develop their first steps in international business through reacting to export orders. These orders could come from anywhere in the world. Once the company becomes more interested, it will become more proactive. It will try to make things happen. It usually does this in markets that do not seem to be too difficult – quite often markets that it perceives to be like its domestic market.

The less difficult markets are those that are either geographically close (sometimes called geographical proximity) or psychologically close (sometimes called psychological proximity).

- ***Geographical proximity***

  Many US companies gain their export experience by exporting to the bordering countries of Canada and Mexico. A similar pattern will occur in most parts of the world.

- ***Psychological proximity***

  Sometimes countries that are geographically distant will seem to be very familiar. This usually happens because of a common language and a similar culture – for example, it is quite common for a UK company to export to Australia or New Zealand, or a Spanish company might feel closer to some of the South American countries than, say, Central Europe.

  Until quite recently, many countries in continental Europe, although geographically close, have seemed psychologically distant to UK companies. The result of this was that UK companies developed markets based on Commonwealth countries. It is only since Britain joined EFTA (European Free Trade Association) and then the European Community that UK companies have learned more about other European countries. As knowledge increases, the psychological distance begins to diminish. The process has, of course, been helped by the abolition of tariff barriers within the EC (now called the European Union (EU) since the formal approval of the Maastricht Treaty in 1993) and large amounts of information from the European Commission and the Department of Trade and Industry (DTI).

Consider the case of a US food manufacturer seeking new markets. Geographical and psychological proximity suggest that Canada and the UK would be appropriate. The similarities in terms of a common language and similar cultural patterns serve to reduce the apparent risks of entering new markets. On the other hand, there are differences. Canada has two official languages – French and English – and packaging will need to be adapted to carry both languages. Similar adaptations will be necessary to take account of the fact that UK English has some differences from US English. Further, the evolution of the US food market might be in advance of the UK and Canada. Thus, not all US food products will be successful in these markets and some might need considerable adaptation.

The early experience in international business gained from expanding into proximate markets can be used as a way of preparing for markets that are more different.

(b) Export selling

The export selling stage is the typical starting point in international business. As its title implies, this is not a focused international approach and the company orientation will be ethnocentric.

The initial reactive approach to unsolicited orders received is likely to change to one where the company seeks to sell, but the company will seek to sell its domestic offering. There will be little or no modification to customer requirements.

The differences in approach between its domestic and its export business will be driven by legal and administrative requirements. So, for example, the ***marketing mix*** changes:

- ***Product*** – this will be modified only to meet legal and technical standards within the country exported to.
- ***Price*** – this will be dictated by currency conversion, by the extra physical distribution management (PDM) costs, by distribution channel cost margin requirements and by local tax requirements.
- ***Distribution*** – this will have to change as new distribution channel members have to be found and PDM decisions are made to transport the product, hold inventory (stock), invoice, insure, provide customs documentation, etc.
- ***Promotion*** – the only element that is usually used is selling, so sales literature might be changed and translated, but sales promotion, publicity and advertising are rarely used.

The export selling approach is essentially casual and does not involve anything more than minimal interaction with the international market. It does not, therefore, integrate the marketing concept into its business activities – having little knowledge of its customers and not considering the overall business environment, and making only minimal attempts to adjust its marketing mix offering to customer requirements.

However, this approach can be profitable. Because of low costs of adjustment and adaptation and a limited use of extra marketing mix resources (i.e. little or no spending on marketing research or on the promotional mix, with the exception of selling), the company incurs few extra costs. Those costs are usually direct costs and are included in the price quoted. At a tactical level, export selling can provide a useful profit addition to the company. The difficulty with this approach is that it is essentially short-term. This approach is more likely to be followed by smaller companies. It restricts their risks, allowing them flexibility to drop in or drop out of markets.

(c) Proactive exporting

At this level the company is beginning to undertake business and marketing planning for various markets. It is, by definition, taking account of customer needs and wants. It will make various adaptations to customer requirements, seek out market opportunities and develop appropriate marketing mix solutions in an attempt to achieve profitable sales.

Proactive exporting will be undertaken by various types of company:

- Small and medium-sized enterprises (SMEs) export to various countries.
- Multi-national enterprises (MNEs) have various subsidiaries in different countries and some subsidiaries will export to smaller or more risky markets.

A frequently quoted criticism of UK exporters is a tendency to spread their efforts too thinly around too many export markets. As long ago as 1976, the BETRO Report, entitled "Concentration on Key Markets", recommended that UK exporters should select a few markets to concentrate on. Such a market concentration (sometimes called the key market) approach involves identifying important markets, becoming knowledgeable about them and devoting sufficient resources to implement an effective marketing plan in each country selected. In this way the company can build a worthwhile market share and gain long-term profitability.

It is useful to balance the key markets or market concentration approach with the opposite approach of market spreading, under which the aim is to sell to markets in many different countries. The market spreading argument, based partly on the justification developed under export selling, is that of low cost, low commitment but a useful profit return. The company has to spread its resources thinly and does not learn much in terms of in-depth information about each country's market. Its sales are small in each country, but equally its costs are low. Another part of the argument is to do with the wisdom of spreading risk. A key market approach which had "all its eggs" in the market basket of Kuwait and Iraq in 1990 would have suffered catastrophic losses with the invasion of Kuwait and the subsequent breakdown in trading.

Many companies find a compromise as the best solution. They identify a number of key markets, usually less than 10 countries, and concentrate long-term efforts on these markets. However, in addition they will export to a number of other countries following the market spreading principles of low cost, low risks, but some profit return.

(d) International business

To fall into this category, a company needs to have made investments in sales offices, distribution systems or production units in other countries. These investment decisions imply greater access to resources and are therefore more likely to be undertaken by larger companies.

You will note that the way in which we have defined international business is very similar to definitions of multinational enterprises. MNEs are organisations that have companies operating in different countries, but are controlled by a headquarters in one given country (invariably the domestic nation of the original company). In practice, they are often thought to be the large blue chip companies – for example, Gillette, IBM or ICI.

Until recently, most MNEs followed approaches that were more multi-domestic than one that segmented international markets in a strategic way. The multi-domestic idea is captured in the polycentric orientation – the management culture became centred on the host country and they became expert in each host country. The end result was a series of adaptations to each country, such as the following in respect of the marketing mix:

- ***Product*** – this is usually standardised, along with brand names.
- ***Price*** – this is adapted according to local costs, competition and customer demand.
- ***Distribution*** – this is adapted to the distribution channels of each country.
- ***Promotion*** – selling is fully adapted to the requirements of the particular country, with sales promotion and publicity being mostly adapted, but advertising will be based on certain standardised creative themes and TV commercials, although media selection is adapted to the host country media.

The connection between MNEs and polycentric orientation is very strong. It results in the various subsidiary companies to be strongly influenced in their strategic planning by the country in which they are based. As a consequence, MNEs had a tendency, as they expanded into more and more countries, to lose a certain amount of control, with the central headquarters often concentrating on the achievement of financial targets.

This type of approach was very powerful when its main competition was on a country-by-country basis. In the 1980s and 1990s, though, competitive forces developed which operate on a world region (e.g. the EU) or on a global scale. These competitors were initially Japanese companies, but other South-East Asian companies are becoming significant (Korean, Malaysian and companies from Taiwan, Hong Kong and Singapore). The new aggressors were able to

benefit from economies of scale through a more standardised approach. They also adopted a more systematic approach to competition. The companies relying on one market at a time became vulnerable to companies that used their resources in a co-ordinated way against several markets.

(e) Global business

A global approach needs to cover a substantial part of the world market for the relevant product or service. This involves identifying global competitive opportunities in order to anticipate and satisfy customer requirements profitably whilst developing and implementing plans which are standardised wherever possible.

There are, essentially, two bases upon which this approach can be built.

- ***The global brand***

  In this approach, the brand needs to have widespread availability in most parts of the world (usually the Triad plus other countries) and to be presented in a more or less similar approach in each market. It will be standardised as far as possible – so, while adaptations do occur, they are contained within a standardised approach. Generally speaking, you should avoid citing Coca-Cola and McDonald's in all your examples, but in this instance they are two of the best examples.

  The global brand aims to have one clear communication of its brand name, its logo and its complete visual identity. Coca-Cola, for example, puts considerable emphasis on the legal protection of its trade mark. The company takes action against those thought to be infringing its trade mark.

  The global brand will have a number of adaptations. These will be confined to areas of important local difference. There will be differences in distribution channels, prices will vary, slight modifications might be sanctioned in the product, and often sales promotions will be localised to the market.

  The global brand will try to standardise visual communications and the expensive elements of the product and TV and cinema advertising. The global brand seeks widespread global availability.

  Note that the standardised global brand is relatively rare. The reasons for this are the wide variations between different market and cultural conditions, differences in distribution channels, different availability of advertising media, and price differences caused by distributor margins and tax levels, etc

- ***The global strategic approach***

  This approach is different from the global brand. The global strategic approach looks at the world (global) opportunity. The approach to standardisation is more flexible. Standardisation will be sought where it is useful, but regional world market variation is allowed. Unilever is a company that is moving from a multi-domestic approach through a regiocentric approach towards a global strategic approach. The end result might be global co-ordination but with different brands in America, Europe and Asia.

Whichever approach is taken, the global company will be following an approach that is now described as ***transnational***. This marks a movement from the MNE multi-domestic way to one that operates over and above country boundaries – they might be physically similar types of company but the transnational will have a company culture and orientation that is geocentric. They often have a strong headquarters influence, usually based in the country in which the

company was founded – for example, Alfa-Laval (food processing equipment) in Sweden, Benetton in Italy, Philips in the Netherlands, etc.

The transnational approach has to accommodate country differences, but it looks for broader market opportunities and solutions. Thus, the response to marketing issues will be on a global scale but with the flexibility for necessary local adaptation. Further, as companies move from a position of treating a country as being synonymous with a market and look at targeting their product offering at consumer segments, it becomes easier to identify the similarities that exist and therefore can be exploited. For example, the student population in the UK, the USA and the Far East are likely to be similar in many ways despite significant cultural differences.

Study Unit 2

Understanding the World Trading Environment

Contents ***Page***

INTRODUCTION

This second study unit is the first of six successive study units which concentrate on the analysis of the international business environment. Remember, environmental analysis is a key task of management irrespective of whether we are considering purely domestic or, as in our case, international business. This involves analysing those factors which provide the context for planning effective business strategies, and in particular the analysis of those factors which give rise to opportunities and threats.

This study unit encompasses some of the broadest aspects of the environment which the international business needs to understand and assess, namely developments and changes in the world trading environment. As you will appreciate, it is impossible to describe all of the developments in this area, and indeed this is not really necessary for our purposes. However, the scope of this area of the syllabus is such that it necessitates two full study units to encompass the area so that you should consider this study unit and the one which follows on Understanding International Trade as essentially one study unit.

In this particular study unit, we shall trace the background to world trade and some of the important dimensions and changes in this area. In the study unit which follows, we shall consider many of the economic and political facets of the world trading environment, including the economic arguments for international trade, trade regulations, world region groups or trading blocs, and some of the major developments in these. You will appreciate that a knowledge and understanding of the world trading environment is essential in as much as it provides the environmental context for developing business strategies and plans. As any historian will tell you, the key to understanding the present, and to some extent, forecasting the future, is an understanding of how the present and future have been shaped by the past and the forces, factors, decisions and developments which have been important in this shaping. In this particular study unit, we shall therefore be introducing some of these key forces and factors which have affected the current world trading environment so we can understand the context in which contemporary international business takes place.

A. THE CHANGING WORLD TRADING ENVIRONMENT

As you would expect, the world trading environment has changed substantially over the years, and indeed will continue to do so. The international business needs to understand how the current world trading environment has been shaped by different forces and factors and how this environment might change in the future. For our purposes, we shall look at what are considered to be some of the major developments in the world trading environment since the end of the Second World War, including the most recent developments in this area. In doing so, we have concentrated on the key characteristics of the world trading environment which have particular significance for the international business.

The Growth of Internationalism

Perhaps one of the most significant developments in the world trading environment since World War II has been the growth of what is often termed “internationalism”. Quite simply, individuals, organisations, governments and whole societies have become increasingly open to the exchange of goods, services, people and ideas, etc. with other parts of the world. We saw in Study Unit 1 that the growth of international trade and business is in large measure due to this increased openness to, and acceptance of, internationalism and we also looked at some of the reasons for this. Factors such as increased travel, international communication networks and the more cosmopolitan consumers and lifestyles which were discussed in Study Unit 1 have all played their part in the growth of internationalism.

Another key factor in this growth, however, has been the increased recognition and acceptance of the need for, and value of, open and improved international relations between countries. For obvious reasons, a major impetus to this recognition and acceptance was the terrible consequences and effect of the Second World War itself. Immediately after the Second World War, therefore, international co-operation began to develop, reliant to a considerable extent on the United States, in an effort to encourage the orderly reconstruction of the world economy. For a variety of reasons, the United States, backed by the United Kingdom, took active responsibility for helping the crushed economies of Germany and Japan to re-emerge. The Marshall Aid Plan and the Bretton Woods Agreement are examples of early efforts to help the world economy and to promote the growth of international relations and trade. Admittedly, with many hiccups and problems along the way, this desire to build international relations and trade has continued over the post-war years and up to the present day.

In Study Unit 3 we shall be considering some of the specific efforts to promote international trade through, for example, the removal of trade regulations and barriers, but in addition to these essentially economic actions to promote internationalism, we have also seen, for example, an increasing level of co-operation between east and west in a variety of areas including technology, arms negotiations and even cultural exchanges. The point here is that, if anything, internationalism as a force underpinning and affecting the world trading environment, is set to become even more important in the future. As we shall see later in the study unit, in part, this underpins the growth of a global approach in international business. The growth of internationalism and the impetus it has given towards the development of world trade, however, contains some important changes in the nature and composition of world trade since World War II which we shall now examine.

The Composition of World Trade

We have already noted in Study Unit 1 that world trade has been one of the fastest growing areas of commercial activity since World War II. This overall growth, however, contains some significant changes in the composition of this world trade. Some of the more important changes include the following.

(a) From primary to secondary products

Shortly after the Second World War, a substantial proportion of world trade was accounted for by trade in primary commodities. So, for example, nations traded their raw materials with other nations, including, for example, wool, cotton, timber, basic food commodities such as wheat, rice and so on, and energy commodities such as coal and oil.

Certainly commodities still represent a large proportion of world trade between countries, but since the Second World War, trade in manufactured products began to increase substantially as a proportion of world trade. This increase included trade in products for manufacturing such as components and machinery, etc., but also and again increasingly, products intended for final consumers ranging from clothing through to electrical products, cars and so on. By the 1970s and 1980s trade in manufacturing products had become the major element of world trade.

More recently, this trade has been increasingly accounted for and fuelled by trade in hi-tech products including, for example, computers and information technology, biochemical products, genetic engineering and so on. In short, world trade is increasingly being dominated in terms of manufacture of products by hi-tech industries.

(b) Service trade

Alongside this growth in the trade of manufactured and hi-tech products has been the growth in the trade of service products. As economies have become more advanced, so service industries within those economies have become more important, to the extent that in some highly

industrialised countries, such as the United States and the United Kingdom, service industries are now more important than manufacturing industries in these economies.

Corresponding to this growth in service industries has been a growth in international trade in services and service products. Admittedly, certain services have always been traded internationally – so, for example, the United Kingdom's trade in financial and insurance services have long been a major part of its trade in world markets. Increasingly, however, international trade in services has expanded to include, for example, transport, tourism, telecommunications, consulting and so on. Many service organisations now operate on a global basis and this growth in the marketing of services in world trade is set to continue and increase. Later on in the course, therefore, we shall be looking at the extended marketing mix for services in the context of marketing internationally.

(c) Not-for-profit organisations

Finally, you should note that the application of business and marketing concepts and ideas to not-for-profit organisations such as charities, institutions and even political parties, is now helping to internationalise many of these types of organisations. In the past, for example, very few charities have operated and certainly marketed, on an international or global basis, but increasingly these organisations can be expected to do so, and, therefore, will begin to take a larger share of world trade, albeit that for obvious reasons this share will never approach the shares accounted for by manufacturing and service industries.

World Trade Shares

Linked to the changing patterns of trade in manufactured, commodity and service products are the changing patterns in the composition of world trade which have taken place since World War II. Shares of world trade can be categorised and analysed in different ways, and we shall examines these by reference to three criteria – by country, by geographic area and by economic categories. Each of these provide some useful and interesting insights into the changing world patterns of trade.

(a) Shares by country

Shortly after the Second World War, and despite the devastation of the levels of trade with the rest of the world wreaked by this, the United Kingdom was still a major player in world markets. Since the 1950s, however, and needless to say, much to the concern of interested parties in the United Kingdom, its share of world trade has continuously fallen. In contrast, the shares of some countries who for long periods of history, and indeed up to the 1950s, had relatively small shares of world trade, have continued to increase over this period. In fact, as UK shares have fallen, some of these other countries have been major beneficiaries. So, for example, Japan, Germany and more recently countries such as South Korea, Hong Kong and Taiwan, have all increased their shares of world trade.

Admittedly, as we shall see shortly, world trade continues to be dominated by the "Big Three" (or "Triad" as they are often referred to) of the United States, Western Europe and Japan, but other countries continue to make inroads into the world shares of this big three. Quite simply, over time, patterns of world trade, as measured by shares of volume and value, evolve and change.

There are numerous and often complex reasons for these changing patterns of share by country. For example, not surprisingly, shares change as competitive advantages change between countries. Generally speaking, the more competitive a country is in the production and marketing of particular products and services, the more likely this country is to increase its world share in these products and services.

Interestingly enough, changing patterns of world trade shares are linked to the area previously discussed of changing patterns of trade in commodities, manufactured products and services. Remember that the fastest growth in world trade in recent years has been in manufactured products, and in particular, hi-tech products, followed more recently by a growth in international services. Obviously, countries which have concentrated on and/or have an advantage in hi-tech or service industries, have increased their shares of world trade at the expense of countries which have concentrated on commodity products. In part, this explains the success of Japan in gaining larger shares of world markets.

(b) By economic category

One of the ways of classifying countries is by their stage of economic development. Hence we can distinguish between:

- Lesser-developed countries
- Newly industrialised countries
- Highly industrialised countries

Perhaps as one would expect given our discussion of the growth in trade accounted for hi-tech and service products, when considering the composition of world trade by economic category, once again the highly industrialised countries have in fact increased their share of world trade. Admittedly, there are some notable exceptions to this, particularly in the case of the newly industrialised category of countries as already mentioned. Taiwan and North Korea in particular have increased their share of world trade substantially, but overall, these are indeed exceptions. The lesser-developed countries in particular have lost out with respect to their share of the rapid growth of world trade, needless to say, adding to their already often severe economic problems.

(c) By region

The world can also, of course, be classified by regions. These regional groupings may be by geographical location, e.g. Western Europe, Africa, North America, Latin America, Asia, etc, or, for example, by political or economic groupings, such as the European Union (EU), NATO countries, Latin American Free Trade Area (LAFTA), etc.

Changing patterns in the composition of world trade are more variable and harder to isolate in this way than when analysed by our previous two categories. So, for example, Asia as a geographical area has been a major player in the expansion of international markets and this is reflected in the increased share of world trade in this region. In comparison, Eastern Europe as a region has tended to lose out in shares of world trade. One thing we can say is that there is a close relationship between economic groupings of countries (particularly those which have formed trading bodies) and their share of world trade, so, for example, countries which belong to the European Union, the Asian Pacific Economic Co-operation, members of the Association of South East Asian Nations and so on have, because of the power and concerted planning associated with such trade bodies and groupings, tended to increase their share of world trade compared to those countries and regions which have not formed such bodies.

A Shrinking World

Another set of factors affecting the world trading environment have again already been referred to in Study Unit 1, namely the speed and ease of travel and the growth of global communication technologies. These have resulted in what is often referred to as a shrinking world. This, in turn, has

had a number of effects on the pattern and nature of world trade, for example, the speed at which transactions can occur between business and customer has been substantially increased.

Communications, including facets such as purchasing and promotion, are increasingly electronically based and facilitated. Once again, it is the more developed economies which have benefited from these developments at the expense of the lesser developed countries.

Uncertainties/Turbulence

Always an uncertain environment in which to trade compared to domestic marketing, the world trading environment has become more turbulent and dynamic in recent years. There is a high degree of political and economic uncertainty when conducting business across international boundaries. Changes can occur very rapidly. Take, for example, the collapse of the Soviet Bloc and the removal of the Berlin Wall as a prelude to the reunification of Eastern and Western Germany.

Both businesses and governments try to remove some of these uncertainties and turbulence through, for example, trading agreements, political treaties and so on. But the speed at which social, technological, political and economic changes take place in the world trading environment has been itself increased by some of the developments already discussed such as global communications, speed of travel and so on. There is no doubt that the world trading environment of the future will continue to be uncertain and turbulent for business.

The Internet and the Worldwide Web

This now ubiquitous technological development is already beginning to affect world trading patterns and practices and we shall return to this area, therefore, at several points during the course. Admittedly, at the moment the amount of global trading on the Internet is relatively small in comparison to other methods for facilitating world trade. However, its impact is growing and it is likely to have a major effect on the nature, patterns and practices of world trade in the future. So much so that no business can afford to ignore this aspect of the world trading environment.

There are a number of reasons why the Internet and the Worldwide Web is likely to become an increasingly important aspect of international trade and marketing. In particular, these technologies and developments facilitate both the ease and speed of conducting transactions across national boundaries. Increasingly, consumers will buy from whichever companies and countries can satisfy their needs, doing all this from the comfort of their own homes. Although the number of people in global terms connected to the Internet and Worldwide Web is still relatively small, more and more people will purchase in this way as computing power becomes increasingly cheap and powerful.

B. THE BIG THREE – THE TRIAD

As we can see, then, the world has changed over the past few decades. It is worth returning to the fact that three parts of the world have become economically significant. The United States of America, a dominant economic force during the 20th century, has been joined by Japan and Western Europe. To give you some idea of their importance, the United States accounts for about one third of the world's annual income, the European Union one third and Japan one fifth. This leaves 10 – 15% for all the rest of the world.

Obviously it would be wrong to ignore the importance of countries outside the big three (or The Triad, as they are called by the well known Japanese writer, Kenichi Ohmae). In some markets, other countries might be much more important. The main markets for mining equipment, for example, might be found in Africa and Australia. However, the significance of the big three should not be ignored. Not only do they represent the big consumer, industrial and government-influenced markets

in the world, but also the biggest companies in most markets usually have their headquarters in one of the three points of the Triad – for example, the world's largest advertising agency, Dentsu, is in Japan and the other main world-size advertising agencies are based in the US, the UK and France. In addition, the world's largest banks and car manufacturers are to be found in the Triad.

The definition of the Triad countries does cause some problems. The definition of Japan is quite clear, but it is less so for the United States (should we include Canada as well?) and is much less clear for Western Europe. Does this mean the current 15 countries of the European Union or should it also include the EFTA countries (Norway, Switzerland, Iceland and Liechtenstein)? This is probably the best way to view Western Europe today. The EU and EFTA signed an agreement to form a trading area to be called the European Economic Area (EEA). You should also note that other countries in Europe have expressed a strong interest in joining the European Union (e.g. Turkey and the ex-COMECON countries, Poland and Hungary).

The success of economic groupings (which will be discussed in more detail in the next study unit) has not gone unnoticed by countries across the world. The tripartite NAFTA (North American Free Trade Association) between the USA, Canada and Mexico may be a precursor to a North American Common Market and there also appear to be efforts towards the creation of a Pacific Rim Common Market (PRCM). These developments may influence the primacy of the Triad in world trade in future years, as may the opening up of the Chinese market.

C. CLASSIFYING THE WORLD

There are over 200 countries in the world. In a changing world, changes in nation states sometimes happen quite easily and sometimes with great difficulty. Namibia emerged in 1990 after a considerable struggle to gain independence from South Africa. Yugoslavia has been ripped apart during the 1990s, making the end result into country divisions difficult to predict. On the other hand, the division in 1993 of Czechoslovakia into two countries, based on Czech lands and Slovakia, was negotiated peacefully.

Classifying by Gross National Product

It would be possible to rank all the countries in the world according to the total size of their gross national product (GNP). GNP data is available for most countries in the world, making it one of the most widely available statistics, and this makes it helpful in comparative analysis.

To facilitate comparison, it is necessary to convert the total GNP for every country to a common currency. It is usual to use US dollars ($), but you should note that, as exchange rates vary, often considerably, the process of conversion causes some distortions and can give different rankings from one time period to another.

GNP figures give an indication of the likely business opportunities in a country. In a very general way, countries with high GNPs will provide larger market sizes than countries with lower GNPs. However, the figures themselves can be misleading – some countries include certain items, whereas others omit them.

A more useful approach than using total GNP is to compare countries on the basis of per capita GNP (GNP per person in the total population). This allows account to be taken of the number of people living in a country to give a more realistic view of spending power. Using this basis, we can divide countries into high income and low income countries. We need to take some dividing line between high and low. This is open to debate, but if, say, $5,000 per capita is taken, we would obtain the breakdown shown in the following two tables.

Examples of High Income Countries

Australia	Libya
EU countries (excluding Portugal)	New Zealand
EFTA countries	Oman
Israel	Saudi Arabia
Japan	United Arab Emirates
Kuwait	United States of America

Examples of Low Income Countries

Afghanistan	Ethiopia	Pakistan
Bangladesh	Gambia	Malaysia
Brazil	Ghana	Uganda
Myanmar (Burma)	India	Vietnam
Chad	Kenya	Zaire

Classifying by Stage of Economic Development

As mentioned when looking at world trade shares earlier in the study unit, there are a number of different ways of grouping countries by stage of economic development. For our purposes we do not need to go into great detail. Remember that one of the most common ways of classifying by stage of economic development is into:

- Lesser-developed countries (LDCs)
- Newly industrialised countries (NICs)
- Highly industrialised countries.

(a) Lesser-developed countries

This group includes most of sub-Saharan Africa, some of Asia and South America. These countries are poor, have low GNPs and often lack many of the conditions for economic development. In particular, they might lack capital, trained and well educated workers and managers, natural resources (for example, good agricultural land, energy sources, and raw materials), a developed infrastructure of transport and communications and political stability.

On the face of it, LDCs offer little encouragement for business. They are often associated with greater environmental uncertainty – political regimes can change abruptly, influencing the other environmental factors – and this, linked with low market size, discourages long-term investment by international companies.

There are, however, some market opportunities and sometimes the hope of growth in the future. Opportunities can result from the spending associated with economic aid packages from richer countries or projects financed through loans from institutions like the World Bank.

(b) Newly industrialised countries

This group would include the South-East Asia countries of Singapore, South Korea and Taiwan. They are sometimes called the S.E. Asian tigers.

There are considerable variations in the industrial development of the NICs. During the development process some countries – for example Brazil – have run into substantial economic difficulties. This can result in high inflation rates, balance of payments difficulties and the imposition of government controls on foreign exchange.

NICs can offer considerable business opportunities. If their development is successful they will usually be growing rapidly. This growth gives increased market opportunities for consumer and industrial products.

NICs also pose something of a threat. In the process of growth, they might aggressively develop their production capabilities as well as their approach to exporting. They might take some export markets from other established exporters and may even penetrate domestic markets of the more developed nations. In addition, NICs often provide a low cost base for production. Moving production to such countries as Taiwan reduces employment opportunities and GNP in the more advanced countries, forcing them, in turn, to move increasingly into more sophisticated products and services with higher amounts of added value.

(c) Highly industrialised countries

This group would include the Triad, but goes wider. One manifestation of the major industrialised nations is the so called G7 – Canada, France, Germany, Italy, Japan, the United Kingdom and the United States – who, as the seven wealthiest nations in the world, meet once a year to discuss economic and political issues. The continued attendance of Russia has raised the expectation that it will eventually be asked to join. Other countries, for example Australia, could be included in the highly industrialised country group.

This group of countries is especially attractive to business. They have high levels of income spent on a variety of consumer and industrial goods and, whilst there are various restrictions placed on exports to these countries (e.g. tariffs, quotas, technical standards and health and safety requirements), they are usually much more open to international trade than the LDCs and NICs.

The sheer attractiveness of this group of countries also results in them being very difficult markets. The existing companies fight hard to maintain market share and they are usually very aggressive towards new entrants into their markets. The Japanese market is usually portrayed as particularly difficult. This is partly the result of very competitive domestic (i.e. Japanese) companies, partly the result of strong cultural differences between Japan and the rest of the world, partly the result of Japanese restrictions, and partly the result of poor quality marketing by companies attempting to enter the Japanese market.

Recent changes in the Chinese market must not be underestimated – growth there is on the verge of surpassing all known records. It is now the world's third largest economy and is likely to be the largest by the turn of the century. However, this growth is not equal across the whole country. Major growth has generally been limited to the coastal regions where approximately one quarter of the population lives and where income is set to grow at 11% per year, whilst inland China should perhaps be included in the LDC category. This will, of course, present particular challenges to international business.

D. A NEW FOCUS – GLOBAL CONVERGENCE

As we saw in Study Unit 1, most companies start by selling to their local or regional markets. There is then a development, as the domestic market becomes saturated, towards an international focus, based on the following pattern:

- Domestic sales;
- Domestic sales with a few exports (usually resulting from reacting to orders received);
- Domestic sales plus exports (exports are now important to the company and it will become more proactive in seeking such opportunities);
- The development of international markets by investing in other countries – setting up sales offices, distribution depots and production units;
- The development of an international approach that looks at world opportunities – a global approach.

Note that the trend is not necessarily a linear one through the various stages in terms of the growth of a company. In very large countries like the United States, companies can become very large but still not have a complete coverage of their national market, whereas in much smaller countries – for example, Finland, Sweden or Switzerland – companies can quickly develop in their own national market and then seek to grow through export markets well before the American company. Also, whilst many companies experience a gradual development towards more sales to non-domestic markets until they reach a point in which international sales are more important than domestic sales, other companies quickly develop a strategic approach that seeks to achieve international success.

There are a number of forces that have encouraged the development of this global approach. However, not all forces are moving companies in this direction and there are significant factors pushing in the opposite direction.

Drivers of the Global Approach

We can identify eight major forces.

(a) Similarity in market needs

Some markets cannot be adequately segmented within country boundaries. The market for jeans or pop music, for example, is widespread and is not restricted to any particular country. Despite significant basic cultural differences the product appeals to a worldwide audience. In business-to-business markets there are increasingly similar needs around the world for computer systems, telecommunications solutions and for, say, business travel.

(b) The high cost of new technologies

New technologies are usually much more expensive to develop than the ones that they replace. Old electro-magnetic telephone systems are being replaced by high cost electronic ones driven by costly software systems. Previously, the electro-mechanical system costs could be recovered by sales within the country. This is no longer possible as the costs are too high. The result is that fewer companies can afford the high research and development costs and few have the operational capability to sell across the world on a sufficient scale to break even on the initial costs. Those that do are the companies that have to take a much wider world view; a global approach.

(c) Communication and transport systems

The development of communication and transport systems that enable rapid message transmission, person transport and freight delivery around the world has resulted in the feeling that the world is becoming a "global village". Whilst this is an exaggeration, it is undoubtedly true that the differences in the world are being reduced by international air travel and international voice and data transmission.

(d) Controlling costs

Increasingly, survival in a tough world depends on driving down costs whilst maintaining or improving quality. Lower costs are increasingly achieved through buying (sometimes called sourcing) products from low-cost countries – particularly newly industrialised countries such as China or others in the Far East or South East Asia. Other companies have established their own factories (or joint ventures) to take advantage of lower labour costs and lower land costs.

(e) Competition

There is a need to develop a more sophisticated approach to competition strategy and the extent of increasing internationalism is very much influenced by the actions of competitors. If competitors are more efficient because they operate globally, then this becomes a strong driving force. With some companies using a co-ordinated global strategy, those competing on a simple national level are at a disadvantage. Companies are being forced to look at markets together – to attack in some and to defend in others.

(f) Transference of experience and learning

The ability of large companies to transfer experience from one market to another and learn from business activities in different parts of the world, means that they are able to apply that knowledge quickly in other parts of the world. They can learn how to do things, and how to do things cheaper, to obtain competitive advantages and improvements in efficiency in all parts of their operations. The opportunities to standardise, make economies and to transfer good practice from one market to another encourage moves to a more and more international approach.

(g) The development of world region markets

European colonisation of large parts of the world had a profound impact on the patterns of world trade over the period from the 16th to the mid-20th century. In some senses, for the developed countries of Western Europe, this trade was almost an extension of domestic selling in that their markets were essentially the colonists in another country. However, the patterns and links between countries built up during this period have endured to provide world-wide markets for both the former colonising powers and the ex-colonies themselves.

Regional groupings like the ASEAN group of countries in South-East Asia and the European Union have similarly encouraged a wider focus. It has become evident that the development of the Single European Market starting in January 1993 led companies in Europe to consider countries with which they had never traded before as being their natural markets.

When this is linked with the pattern of trade resulting from the history of European colonisation, you can see the opportunity for a more global approach.

(h) Quality

Quality has become a major factor in market success. Good quality has always been important, but in increasingly competitive market-places, the goal is a zero defect, total quality every time

philosophy. This approach was spearheaded by Japanese companies and their success has meant that others have had to follow suit.

A further factor here is the increasing use of ***benchmarking***. This is the process of a company comparing its performance across a range of indicators with others in the same or similar industry. The aim is to achieve continual improvements along the path to the goal of excellence. The approach of drawing comparisons with the best performing companies inevitably causes the company to look at international competitors.

The reason why quality necessitates a global approach is that high quality demands excellent systems. It is easier to spread the costs of those systems if the sales volume is high – hence the need for a wider than domestic approach.

We should note, though, that developing approaches to take advantage of these drivers is not, of itself, a guarantee of success. As with all business, it is necessary to develop ***sustainable differentiation*** to achieve success. Whilst lower costs need to be gained, it is difficult to sustain lower costs than the competition over a long period of time. Technologies change, markets change and, therefore, past cost advantages can disappear. Companies have to develop superior systems and superior brand and company images to make customers prefer their product.

Forces Working to Keep Markets Localised

Whilst these drivers toward global business are strong, you should not form the impression that the trend is inevitable in all aspects. There remain a number of forces which work to keep markets localised.

(a) Market differences

There will always be particular differences between markets. For example, different countries have different climates and different cultures – warm clothing is necessary in Scandinavia, but cool clothing in Central Africa, and frogs' legs and snails are delicacies in France but few will eat them in England.

(b) History

Companies will have different market shares and different competitive positions in different country markets. It is often difficult to standardise these differences to go for a global approach.

(c) National controls/barriers to entry

As we shall see in the next study unit, most countries will have tariff or non-tariff barriers (NTBs). These restrict entry and increase costs and delays – all resulting in difficulties in the development of global business.

(d) Management myopia and organisational culture

In some companies, the wider international and global opportunities are not seen because management is too wrapped up in its domestic market. The global approach requires vision, international experience and a good understanding of managing complicated organisations.

Study Unit 3

Understanding International Trade

Contents ***Page***

INTRODUCTION

This study unit continues the process of understanding and analysing the world trading environment begun in Study Unit 2. In this study unit we shall be looking at the economic rationale for international trade, introducing, in the process, some of the major theories which have been proposed to explain why, and how, nations trade. We shall also explore why international free trade is generally favoured and supported by economists and many governments, and how, despite this support, there are also many barriers to international trade. Finally, we shall review the main international bodies which influence, promote and to some extent regulate world trade, and consider the world's major economic regional groups or "trading blocs" as they are often called.

A. THE REASONS FOR INTERNATIONAL TRADE

International trade, of course, is not new – nations have been trading, and often fighting to trade, with other nations for thousands of years. The simple reason for this is that trade, and especially international trade, brings wealth and economic growth. Furthermore, few countries if any, can be totally self-sufficient in all the goods and services that are needed to be consumed within a country. The only solution is to do without or trade with other nations.

Sometimes, of course, nations trade with other nations for non-economic reasons – for example, to develop international relations with other countries for strategic and political reasons, or perhaps even to help other nations develop their economies. The primary reasons for international trade, however, are essentially economic. Perhaps as we would expect then, it was the economists who first provided a rationale and a set of theories to explain the reasons for, and the patterns of, world trade. We shall begin by examining the economists' earliest theories of trade before moving on to consider more recent theories, including the emergence of more market and competitor-based theories of trade.

Theories of Advantage and Factors of Production

The 17th and 18th century economists were amongst the first to provide a rationale for international trade. Perhaps the first recognised theory was that developed by Adam Smith based on the notion of ***absolute advantage***. This theory was further refined in Ricardo's theory of ***comparative advantage***. Each of these theories is outlined below.

(a) Absolute advantage

This is developed from the work of Adam Smith in "The Wealth of Nations" published in 1776. If one country can produce, for the same costs, more products than another country, there is an advantage to be gained by specialising production in the higher-output country. In effect, the costs per unit are lower.

(b) Comparative advantage

Attributed principally to David Ricardo, the important idea here is the economist's concept of forgone opportunity. In producing, say, aeroplanes, the opportunity to produce consumer durable products will be missed. The ideal approach is to concentrate on those products and services that give the best relative position.

To take an extreme example, country X might have an absolute advantage over country Y in every type of product and service. Country X should concentrate on those items that give the best returns – those items in which it is able to add most value. It is probable that country X will concentrate on complicated manufacture requiring a talented and well educated and trained workforce. Country Y will produce more straightforward products and services. X will gain

because it produces more high added value items. Y will gain because it will have access to the products produced by X at lower prices than Y could achieve.

These early economic theories were very influential, not only in exploring the rationale for international trade but in doing so, providing the basis for the promotion of such trade by governments and individuals. There is no doubt that the major legacy that these early economists left was the justification, ever since, for the protagonists of free trade. Important and influential though these early theories were, they did have shortcomings, particularly as countries and international trade itself began to develop further. Changes in the patterns of international trade led to two further additions to the economists' theories of international trade – in particular, the so-called ***productivity theories*** and the ***factor proportions*** theory. Each of these theories is outlined below.

(c) Productivity theories

There are various explanations for trade flows that look in detail at the productivity of factors of production. Early theories concentrated on the productivity of labour. If one country had people who produced more products or services, their costs would be lower. Trade would flow from this country to the other less productive countries.

The weakness with the labour productivity theory is that labour is not the only factor of production. In the 20th century, the full range of factor costs or factor output per time period is still important. However, this needs to be balanced by the different factor inputs. Some companies can compensate for high labour costs by applying capital to increase the use of machinery. In addition, those companies tend to specialise in advanced innovative products with high levels of service. Germany and Sweden, both high-cost labour countries, are examples of this approach.

(d) Factor proportions theory

This theory assumes different factor proportions for different products. It also assumes that different countries will have different amounts of resources (i.e. factors of production). For example, if the UK wishes to gain more exports, it might wish to consider investing in education and training to develop a workforce capable of generating the kinds of added-value, knowledge-based products and services likely to be demanded in the future.

More Recent Theories of International Trade

We have seen how dynamic the world trading environment is. In order to explain some of the changes in the patterns of world trade which we have seen in recent years, a number of comparatively new theories of international trade have been developed which reflect some of the marketing and competitive strategy reasons for the nature and patterns of world trade. Amongst the most important theories to emerge recently, are the so-called "Diamond" approach theory developed by Michael Porter and Raymond Vernon's theory of an "International Product Lifecycle" which was briefly introduced in Study Unit 1. Each of these theories is outlined below.

(a) The "diamond" approach

Recent work by Michael Porter developed from dissatisfaction with the completeness of comparative advantage based on factors of production. Porter concludes that "at best, factor comparative advantage theory is coming to be seen as useful primarily for explaining broad tendencies in the patterns of trade (for example, its average labour or capital intensity) rather than whether a nation exports or imports in individual industries".

The problems with the standard theory of factor comparative advantage are that it assumes:

- That there are not economies of scale.

- That technologies everywhere are identical.
- That products are undifferentiated.
- That the pool of national factors is fixed.
- That factors such as labour and capital do not move between nations – whereas, for example, the Single European Market is designed to allow the free movement of factors of production across the national boundaries of the member countries of the EU.
- That all firms follow the same strategy.

It also makes no allowance for the competitive forces that operate within industries.

The explanations of the classical economists were much more appropriate for the 18th and 19th centuries. During this time, industries were more dependent upon local supplies of raw materials and production was more labour- and less skill-intensive. Most industries were fragmented and there was little concentration of power. Business acted in a way that was close to the economist's concept of the perfect market.

During the 20th century, industries have become more knowledge-based, with higher levels of capital employed relative to labour. Industries are no longer forced to exist close to raw material supplies. Japanese industries rely on raw materials transported hundreds and thousands of miles. Industries are now, usually, composed of a few large companies along with many smaller companies. The concentration of power generally follows the Pareto principle of the 80:20 rule. In these situations, strategic decisions by the major companies (sometimes they are referred to as players) can change the industry shape, and can influence which countries export and which ones import the goods that they manufacture.

In seeking answers to why nations achieve international success in a particular industry, Porter has constructed a diamond-shaped diagram. The four broad attributes that shape the competitive environment that help or hinder the creation of competitive advantage, are placed at the four points of the diamond. The four broad attributes are:

- ***Factor conditions*** – the types, availability and quality of the factors of production.
- ***Demand conditions*** – the demand patterns in the domestic market for the company's product or service.
- ***Related and supporting industries*** – the existence or otherwise of internationally competitive companies that provide components, systems and other services.
- ***Company strategy, structure and rivalry*** – this point includes much of Porter's original work on the competitive forces facing companies in an industry. How are companies created, organised and managed? What are the competitive pressures in the country for this industry?

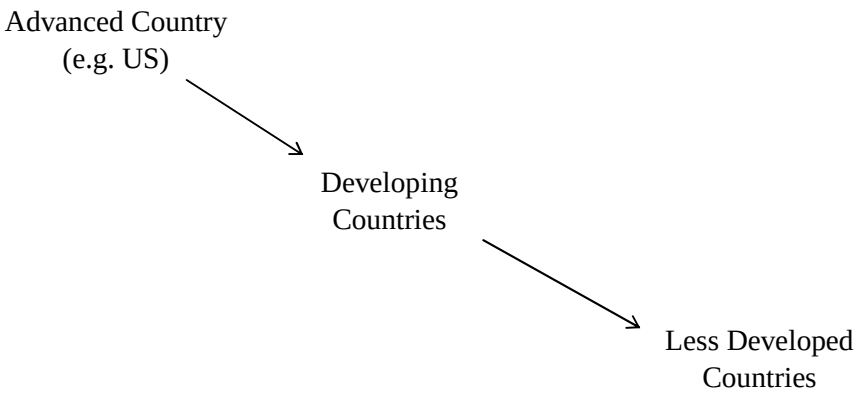
A significant factor appears to be the development of sufficient expertise and support to enable the industry to grow. The growth must, however, be accompanied by the strong shaping force of competition. In this way the industry becomes internationally competitive and will be able to export goods and services to other countries.

(b) International product life-cycle

The standard product life-cycle (PLC) concept was applied in the 1960s by Raymond Vernon to international markets. The basic idea was a "trickle down" from advanced countries to the less advanced countries.

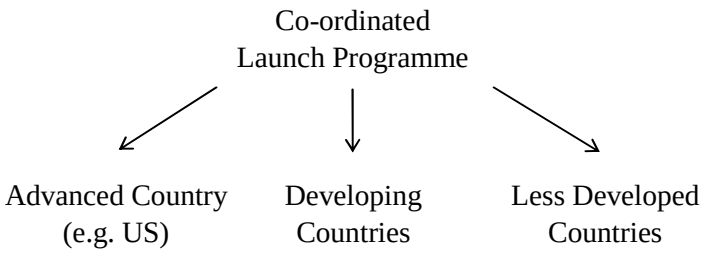
It assumes that advanced countries will innovate products and services. Over time, these new products will mature in their domestic markets and will, then, be introduced into the developing and the less developed countries. In these countries the PLC will start with the introduction phase, etc. Thus, products would be developed in, say, the US, but the PLC for that product would be straddled across the export of the product to less developed markets.

Figure 3.1: The trickle or cascade approach



This approach is much less likely to happen in the turbulent 1990s. Many companies take a strategic approach to product development and product launch, with products often being launched, in a co-ordinated way, into several markets at once. This more modern approach has been referred to by Keegan as the ***shower approach***.

Figure 3.2: The shower approach



In addition, the concept of the international PLC does not take account of other changes in the late 20th century:

- New products and services are being developed in many different countries, not just advanced countries.
- There are fewer demand differences between countries. We have not moved to the global village, but there are considerable signs of convergence.

(Note that, despite these reservations about the international PLC, there is little doubt that the original concept of the product life-cycle will operate for each product in each country market.)

B. TRADE BARRIERS

Many of these theories of world trade, and particularly those of Adam Smith and Ricardo, sought not only to explain the rationale of international trade, but also the benefits and therefore the importance of this trade being unrestricted or free. As we shall see shortly, this explains the commitment of many governments to developing free trade by removing restrictions and the formation of world trade bodies and institutions to promote and facilitate the growth of such free international trade.

Notwithstanding this, however, and notwithstanding, as we shall also see later, concerted and continuing attempts to remove them, there exist a number of barriers to international trade which serve to make such trade more difficult and sometimes impossible between nations. Before we look at some of the world trade bodies which exist specifically to promote freer world trade, we need first to understand some of the main reasons and types of trade barrier, together with the notion of "dumping" in international trade.

Reasons for Erecting Trade Barriers

Countries, or rather governments, may erect trade barriers for a number of reasons. Some of the most frequent reasons are as follows:

- Protection of home markets/industries and employment. In some instances, barriers might legitimately allow an infant industry to establish itself before the full forces of competition can shake it, perhaps to breaking point. In other instances, the barriers might allow the domestic industry to become inefficient, resulting in domestic consumers paying higher prices and having less up-to-date products and, perhaps, lower levels of customer service.
- Strategic (military) reasons.
- Retaliatory reasons – political, economic, etc.
- As bargaining levers to secure desired objectives in international relations with other countries.

These, then, are some of the major reasons (or rather justifications) for introducing and/or increasing trade barriers. One author has in fact identified some 850 different types of trade barrier used by countries and companies, but the main categories and types found in international markets are outlined below.

Tariffs

Tariffs are taxes or duties that are placed on imports and their use is widespread around the world. The purposes of tariffs vary from a means of raising revenue for a government to creating barriers to entry to the domestic market.

The main types of tariff are as follows.

(a) ***Ad valorem***

This is the adding of a surcharge as a percentage value of the goods – say, for example, 9% – to the landed price of the product at the port of entry.

(b) **Specific duty**

This is a duty charged on the physical specifications of the product – for example, two dollars per ton of steel. In this instance the duty falls more heavily on lower priced, less-value-added variants of the same product type. A special steel might have a much higher market value than ordinary steel. With a specific duty, both would be charged at the same rate. Obviously the percentage increase in price is higher for the ordinary steel than it is for the special steel.

(c) Special and temporary tariffs

In some instances, countries will apply surcharges to increase the price level for specific goods. This may be to protect particular domestic industries or, sometimes, may be applied as an anti-dumping measure.

In addition, ***compound*** or ***mixed duties***, which are combinations of types (a) and (b) may be applied.

Non-Tariff Barriers (NTBs)

Whilst there has been a general reduction in the range and levels of tariffs, non-tariff barriers have tended to increase. For example, the Single European Market eliminated tariffs between the 15 member states, but is still wrestling with the need to harmonise NTBs.

The main types of non-tariff barrier are as follows.

(a) Public procurement policies

This is selective and discriminatory buying policies on the part of governments and state-owned-industry. In many countries there is either an explicit or implicit "buy our own national products" policy (e.g. in the UK, "Buy British", in France, "Buy French").

In the EU, no favouritism can be shown to national or local suppliers. Goods and services have to be selected either at the lowest tendered price or by an agreed "best value" formula.

(b) Quotas

Under this type of barrier, only a specified amount of particular goods are allowed to be imported during a time period (usually, over a year). Once this amount is filled, no more goods can be imported until the next time period.

This restricts the potential market for exporters and makes it easier for domestic producers to gain market share. In addition, the exporter is faced with uncertainty – it might be difficult to establish whether the quota is full or not. If the quota amount has been reached, the exporter will have to wait until the next time period when the quota resumes.

(c) Technical standards

Many countries have technical requirements applying to specific goods within the domestic market. Sometimes these can be used to make it easier for domestic suppliers than those seeking to gain entry. The domestic suppliers might understand the regulations better, perhaps continually changing the regulations to keep the balance of advantage on their side.

(d) Health and safety standards

These can be used in much the same way as technical standards.

(e) Restrictive administration procedures

A classic example of this occurred during the 1980s when the French attempted to slow the entry of Japanese-made video cassette recorders. They did this by making the only entry into France through one town for Japanese video cassette recorders. This caused very considerable delays.

Dumping and Anti-Dumping

Although generally speaking, barriers to trade are, in economic terms at least, largely indefensible, there are sometimes good reasons for imposing them, at least in the short term. One situation where

barriers to trade might be justified is in the case of anti-dumping legislation which is enacted to protect a market from unfair competition.

Dumping occurs when a product is sold in another country at a price below its actual costs. There may be some difficulty in establishing what the actual cost is – it can be argued that it should include all costs (i.e. direct and indirect costs) although it is generally agreed that, in the short term, the price should cover the direct, attributable costs of producing a specific quantity of product.

There are three main types of dumping:

(a) Sporadic

This happens from time to time, usually as a result of surplus inventory or stocks. A company might prefer to find an export market to unload the surplus rather than risk unsettling the domestic market in which the company has a major interest.

(b) Predatory

This is a type of competition strategy in which a company seeks to destabilise a market with the objective of gaining market share by selling at very low prices. Once the domestic producers are driven out of business, the company can increase prices and recover profit levels.

(c) Persistent

This is the continued sale of products at very low prices. This was a particular problem with ex-COMECON countries where, in countries like Poland, Hungary and the USSR, prices and costs were established arbitrarily by central planners. Costs and prices showed no relationship to conventional Western accounting practices.

Most countries have anti-dumping legislation. In the main, this revolves around particular commodities – steel, coal and basic industrial chemicals, textiles and agricultural produce. Such actions are permitted under WTO (see later) rules under two specific criteria:

- Sales at less than fair value;
- Material injury to domestic industry.

Note that anti-dumping rules influence both domestic and international markets. In domestic markets, home-based companies have a measure of protection from unfair competition caused by very low prices from imported goods. This is necessary to prevent them losing market share with damaging implications for both the companies concerned and the domestic economy as a whole. In international markets, businesses are restricted in respect of their pricing policies, because very low prices will be challenged by anti-dumping actions.

C. WORLD TRADE BODIES AND INSTITUTIONS

We have already discussed the fact that the early economists established the rationale and the benefits of free world trade. During the 1920s and 1930s, a major recession spread throughout the world. As economies collapsed, governments sought to maintain domestic output and employment in their own economies and a wave of trade protectionism swept across the globe. Tariffs, quotas and outright bans on imports were introduced in a bid to prevent industries collapsing further.

We now know, of course, that this did not help. Indeed, as Smith and Ricardo would have predicted, it made the worldwide recession even worse.

Economies were just beginning to recover from this recession when the Second World War intervened. As a result, a large part of international trade, or at least conventional trade, collapsed, as

did many economies as a result of their war efforts and damage to infrastructure and industries caused by hostilities.

By the end of the war, therefore, many economies were totally crippled and some countries such as Germany and Japan were totally crushed. In an effort to help these countries, and thereby the world economy, a number of international bodies and institutions were formed, principally with the objective of helping this worldwide reconstruction, but underpinned very much by the philosophy of promoting the growth and return of free world trade. Since their establishment, some of these bodies and institutions have had a major influence and impact on world trade and continue to have an important impact still today.

Of particular significance and importance are the General Agreement on Tariffs and Trade (GATT), more recently known as the World Trade Organisation (WTO), the International Bank for Reconstruction and Development (often referred to as The World Bank) and the International Monetary Fund (IMF). Each of these is discussed below.

The General Agreement on Tariffs and Trade (GATT)/The World Trade Organisation (WTO)

GATT was set up after World War II in an effort to avoid the difficulties of the 1920s and 1930s. During the inter-war years the world recession had been compounded by countries' individual policies on importing and exporting which were aimed at ensuring their preferential position in the international market-place. GATT aimed to create order and predictability in world trade with the objective of encouraging the development of this trade around the world.

GATT as it stands today is not just one treaty agreed in 1948, but a large cluster of around 180 which over the years have shaped its constitution and thus its direction, its membership and its mission. There have been seven negotiating "rounds", each lasting an average of nine years, which clearly demonstrates the complexities of the issues which GATT tried to address in a fast changing world trading environment.

Following the approval of the Final Act of the Uruguay Round of GATT in 1993, the World Trade Organisation (WTO), a permanent body with a status commensurate with that of the International Monetary Fund or the World Bank, effectively replaced GATT.

It is the responsibility of the WTO to monitor agreements to reduce barriers to trade, such as tariffs, subsidies, quotas and regulations which discriminate against imported goods.

All members of GATT automatically became members of the WTO on ratification of the Uruguay Round. Currently, the WTO has 132 members and a further 29 countries which have observer status.

The aim of the WTO is to create order and predictability in world trade. The principles that are embodied in the WTO are:

(a) Reciprocity

The idea is that if one country reduces its tariffs against another country's exports, then it can expect the other country to reduce the tariffs against its exports.

(b) Non-discrimination

Under the terms of membership, nations agree to apply their most favourable tariff rate to other WTO signatories. It is, however, possible to have preferential rates which may be used to encourage trade with particular nations. For example, the UK may wish to use a preferential rate with Commonwealth countries, particularly those that are less developed. The highest

degree of preferential status is the "most favoured nation" (MFN) status and is accorded on a bilateral basis.

In recent years the granting or withdrawal of MFN has been seen as a political means of rewarding or punishing countries. For example, President Carter of the United States of America withdrew MFN from the USSR over the human rights issue with the Communist country, and President Reagan withdrew MFN from Central and Eastern European countries when martial law was imposed in Poland.

The potential economic impact of either loss or gaining of MFN status should not be underestimated. As we have already discussed, self-sufficiency is virtually impossible and the stability of most countries' economies is tied into the import and export market and more importantly into the country's position within that market.

(c) Fair trade

This principle prohibits export subsidies on manufactured goods and limits their use on primary products.

Whilst the aim and principles of the WTO are relatively simple, the complexities surrounding their application and indeed their influence as we begin the new millennium must not be underestimated.

Since the establishment of GATT, more and more groups of countries have looked to become unified from an economic viewpoint, the European Union being perhaps the most successful to date. Increasingly the dimensions of the Pacific trading markets are changing as a response to shifts in regional trade flows. Economic indicators are pointing to an increasing interdependence among these nations. At the same time, Europe continues to debate the strengthening and extension of its economic ties.

The impact of the WTO can appear to be most significant at a national level. However, its potential impact at an organisational level is something that should not be overlooked and we will consider this further in the next unit when we look at influences on the international business environment.

The WTO is not without its critics. Towards the end of 1999, anti-globalisation protestors held a series of demonstrations which turned into riots outside the building in which the WTO was holding its next round of meetings. There were a number of reasons for these protests, but essentially, a number of critics feel that the WTO represents the interests of the highly industrialised countries, and particularly of the United States, at the expense of the lesser-developed countries. This, they suggest, continues to repress these developing countries, despite the WTO's commitment to raising the living standards for all the people of the world. There are also those who believe that the WTO represents the epitome of commercial greed and capitalism and hence are determined to destroy it. Yet others believe that world trade helps destroy the environment. These demonstrations were so successful that the discussions had to be postponed. There is little doubt that the interests of such pressure groups and a more socially responsible attitude will have to be taken into account in any future considerations by the WTO.

The International Monetary Fund (IMF)

The idea for the IMF was developed at the Bretton Woods Conference in New Hampshire, in the United States, towards the end of World War II in 1944. The IMF was designed to provide a stable framework for international currencies. Members of the IMF subscribed to a quota based on expected trade patterns. One quarter of the quota was to be paid in gold or dollars and the rest in local currencies. The funds were to be used to provide support for currencies during fluctuations in exchange rates and thus provide stability in the foreign currency exchange rates which are so important to the development of world trade.

The original intention of the IMF was to provide a support system for fixed exchange rates between countries. However, in 1971, the US abandoned the gold standard and devalued the dollar, the end result of which was the development of flexible or floating exchange rates instead of the fixed rate system.

The structural problems of developing countries often pose grave difficulties for the IMF in finding acceptable ways to support the developing country whilst at the same time safeguarding the funds of the IMF. In the 1980s, the IMF had to cope with severe difficulties experienced by a number of lesser-developed and newly industrialised countries – for example, Mexico – as a result of their substantial accumulated debts that they were unable to pay. In the 1990s, the IMF had major new pressures resulting from the collapse of the USSR when many countries in Central and Eastern Europe needed economic and foreign currency support during their reconstruction.

The World Bank

The World Bank, officially called the International Bank for Reconstruction and Development, was also founded in 1944. Its initial role was to assist the redevelopment of countries crippled economically by World War II. Since the completion of this role, the World Bank has played a major part in developing the economies of the poorer countries – particularly new countries emerging into independence from their former colonial status, such as Nigeria and India (from the UK) and Mozambique and Angola (from Portugal).

The World Bank finances several hundred major projects each year. Loans must be repaid, with interest, and are subject to guarantee by the government of the borrowing country. The projects range from developments in agriculture, to telecommunications, to population planning, and there are international business opportunities to be gained from World Bank projects.

The World Bank is also not without its critics. Again, the main criticism is that many of the lesser-developed countries who have been recipients of World Bank funds in earlier years have effectively been crippled economically by their large debt repayments and interest charges. In fact, some countries will never be able to repay the interest, let alone the capital and so their debts will simply accumulate. Recently, steps have been taken to address this problem. Some countries have had their debts reduced, and more recently, the United States and the United Kingdom have cancelled some of them completely.

D. WORLD REGIONAL GROUPS OR TRADING BLOCS

Various groupings of countries have existed throughout the history of the world. These groups, in the past, were based on empires, for example the Roman Empire. More recently we have seen the grouping of countries into various types of coalition and federation.

The reason why countries should group together is usually to encourage trade between them. Subsequently, other forms of economic, political and social integration might be sought.

Here we shall be looking at some of the major world regional groups or trading blocs. There are literally dozens of such groups throughout the world if we consider informal groupings, but we are only concerned with the largest, most powerful and influential. These are listed in the table below, together with the part of the world in which they operate and their current member countries.

Table 3.1: Major world trading blocs

Abbreviation	Title/Area: Member Countries
NAFTA	North American Free Trade Agreement: Canada, Mexico and USA
EU	European Union: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and UK
ASEAN	Association of South East Asian Nations: Indonesia, Malaysia, the Philippines, Singapore and Thailand
LAIA	Latin American Integration Association: Argentina, Bolivia, Brazil, Chile, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela
MERCOSUR	Southern Common Market: Argentina, Brazil, Paraguay and Uruguay
APEC	Asia Pacific Economic Co-operation: Some 23 Asia Pacific nations including US

Types of Grouping

There are five main types of market grouping or trading bloc. We can see that there is a progression through these groupings in terms of their having increasingly ambitious aims.

(a) Free trade area

This is an area which has no internal tariff barriers between member countries. Each country can have different tariffs with other countries. Examples include ASEAN or EFTA.

(b) Customs union

This builds on (a) by developing common external tariffs between the members of the union and non-member countries. Until the end of 1992, the European Community was a customs union.

(c) Common market

This builds (a) and (b) by allowing the free flow of factors of production within the external boundaries of the combined member countries – for example, in respect of the mobility of people who have the right to live and work in any of the member countries. The European Community moved to a common market phase from 1 January 1993.

(d) Economic union

This is achieved when the market group shares a common currency, central bank and other aspects of a harmonised economic policy.

(e) Political union

This would be the final step in the harmonisation process.

It is important to be aware of the changing nature of these groupings. Thus, some world regional groups are developing and moving through the stages from (a) towards (b) and (c) and perhaps (d) or even (e). Others are seeking to consolidate their position and draw in more members, thus increasing their regional spread. At the same time, yet others have been less successful and started to break up.

Note, too, that different types of group present different threats and opportunities to international business. Remember that the reasons for the grouping will include similarity of member interests and a probable increase in trade between the member countries of the group. Thus, a free trade area developing in the countries of Southern Africa will encourage trade between the member countries, whilst those outside the free trade area might find it more difficult to export goods to countries inside the group.

It is important to be aware of the implications of different tariff policies. In a free trade area, there might be different tariff levels, say 5% in one country and as much as 20-50% in another country. This will result in considerable price variation and therefore the need for variety in marketing from one country to another. Within a common market, a common tariff will be in force – the tariff level will be the same for each member country. Thus, marketing differences will be based on market and customer differences rather than the tariff difference.

The European Union (EU)

As already mentioned, it is impossible to describe all of these trading blocs, their history and their aims, objectives and operation in detail. As an example, therefore, we shall consider the development, objectives and policies of the European Union in some detail, as well as noting the implications of this form of trading bloc for businesses. (It would be a good idea to build your own fact file about perhaps two more of the other trading blocs.)

(a) A brief history

The Treaty of Rome established what was then called the European Economic Community (EEC) on 1 January 1958. The original six member countries – Germany, France, Italy, Belgium, The Netherlands and Luxembourg – have, over the years, been joined by nine other countries:

1973 The UK, Ireland and Denmark

1981 Greece

1986 Spain and Portugal

1995 Sweden, Finland and Austria

The European Community established a close relationship with EFTA. This has resulted in the formation of the European Economic Area (EEA). There are no tariff barriers within the EEA. This extends the tariff-free area beyond the 15 EU countries to:

Iceland, Liechtenstein, Norway and Switzerland.

There are a number of preferential trade agreements between the EU and a number of less developed Caribbean, Pacific and African countries. These were incorporated into the Lomé Convention signed in 1976.

A major impetus for the EC occurred in 1985 with the issue of the EC White Paper, “Completing the Internal Market”. This resulted in the Single Market Act which was enacted in 1992 by the UK and in 1993 by most other Europeans. The Single Market was designed to create the freedom of movement of goods, services, capital and people. To do this a large number of barriers needed to be dismantled. The customs union phase of the EU had eliminated internal tariff barriers and created common external tariff barriers. However, many non-tariff barriers remained (for example, different technical standards, different health and safety regulations, etc.).

A strong logic for the creation of the Single Market was to improve the performance of Europe. The EU with over 370 million people is larger than the United States (250 million) and Japan (125 million), and yet, in almost all respects, it was being outperformed by the US and particularly by Japan. A dynamic, unified EC (in 1985 the major recession of the early 1990s was not predicted) would achieve faster economic growth. The main ways to achieve this were through:

- Eliminating different technical standards
- Eliminating border crossing documentation and delay
- Eliminating inefficient national preferences in public procurement contracts
- Eliminating restrictions on citizens of the EC from living and working in other member states
- Reducing the controls on financial and capital movements
- Harmonising VAT and excise levels
- Economic and Monetary Union.

The last step, i.e. the move towards economic and monetary union is perhaps the most far-reaching, and hence controversial of the developments of the EU so far. A major step itself towards achieving economic and monetary union was the introduction of European Monetary Union (EMU) in 1999.

The main features of the EMU are the establishment of a single currency (the Euro) and control of European interest rates through the European Central Bank. Individual countries could only join the EMU if they met strict conditions and criteria with regard to, for example, their interest rates, growth in GNP, inflation and so on. But some members, most notably the United Kingdom, have at this stage decided not to join the EMU and the single currency, but rather to wait and see how it works. In the event, 11 of the founder members joined the EMU with the United Kingdom negotiating an opt-out. At the moment it is too early to say how well the single currency is working, but it will certainly not be before 2002 at the earliest that the UK considers joining, and perhaps not even then.

Nevertheless, the introduction of the single currency has already begun to affect trade in the European Union. By 2002, all of those subscribing to the single currency will be trading in it. Many companies in Europe are now pricing in Euros, including, in fact, UK companies. There is no doubt that the European Monetary Union will have a major effect on trade in this bloc in the future.

A final point to note about the EU is that it is set to increase in size substantially over the next ten years. At the moment, at least ten central European countries want to join including, for example, Hungary, Poland, Czech Republic and the former Baltic Bloc republics. Turkey, too, has been wanting to become a member for some time. The current EU members are committed to enlarging this already substantial trading bloc. It will therefore continue to present major opportunities and threats to business.

(b) Business implications

The Single European Market has changed the environment in which business operates. Freedom of trade means that the EU countries can be evaluated as a single geographic region. This makes it a very large market – and one which, if the aim of making the economies of the EU countries more competitive is successful, will expand more rapidly than would have been the case. Growing markets are very attractive to business and an increase in competition may

be expected, both from within the EU or from outside. This is already becoming evident with investment by multinational companies in individual EU countries as a means of getting a foothold in the market (for example, Toyota have built a car factory in Derby, England).

There are opportunities to gain grants and contracts from the various EU-financed programmes. These programmes support a range of social, educational and technological initiatives across the whole of the EU. There is also a flow of money from the EU budget in support of agriculture and to promote development of the poorer parts of the EU – mainly the Mediterranean countries and Ireland.

As the EU consolidates its achievements and prepares for expansion through additional members, companies need to be aware of the changing nature of the business environment and adjust their plans and activities to take account of the implications. Thus, continuing changes to EU-wide regulations designed to eliminate barriers and harmonise business practices – for example, in relation to product standards and working practices – mean that business needs flexibility to maintain compliance. The introduction of a single currency and the fact that not all major European countries have agreed to join at the outset will also need careful consideration.

Study Unit 4

Understanding the International Business Environment

Contents ***Page***

(Continued over)

INTRODUCTION

Business and marketing strategy, whether it be at home or abroad, can only be effective if it is developed to meet the specific needs of a target group. In this study unit, we will use a structured way of analysing the external environment which faces the company in an international setting and which, importantly, influences the purchasing decisions of the customer.

Although there are a number of ways in which this may be approached, the most common form of analysis in marketing is characterised by the initials "SLEPT" – looking at **s**ocial (or social/cultural), **l**egal, **e**conomic, **p**olitical and **t**echnological factors. We shall use this approach and consider each element separately.

In addition to the SLEPT factors, we will also look at the significance of the "C" factors – **C**ountries, **C**urrencies and **C**ompetitors. These too have a substantial influence on the external environment of international business.

Finally, we will also look at additional and increasingly important ethical, social and green considerations in the international business environment, together with the role of pressure groups.

A. SOCIAL/CULTURAL FACTORS

The social/cultural element is particularly important in SLEPT analysis and plays a considerable part in determining how the legal, economic, political and technological elements work.

It is important at the outset, though, to raise a word of caution in looking at these factors. There is sometimes a tendency to treat social and cultural differences in a rather superficial way by thinking about stereotypes – for example, the British as being reserved, Americans as being loud, Afro-Caribbeans as being colourful and gregarious, etc. This is a dangerous oversimplification and needs always to be avoided.

We have linked social and cultural factors together because they are so inextricably connected.

Social factors are reasonably straightforward to identify in terms of the concepts of reference groups, social roles and status.

- Reference groups are all those groups that have a direct or an indirect influence on a person's attitude or behaviour. These include family groups, friendship groups, workplace groups, religious groups and professional groups. The family probably represents the most important primary reference group that will influence a person's life.
- In each group to which a person belongs (and it is important that we remember that individuals will belong to a number of groups), his or her actions and influence in that group will be determined by the role and status of the position held. For example, a woman within a family may have a number of roles – wife, mother, daughter, etc. If she also has paid employment, her role and position within the organisation in which she works is likely to be very different from that or those within the family.

But what influences these reference groups? Why do they behave the way they do? Thinking of the family it is easy to see that this varies a great deal from country to country. The answer is culture.

Defining Culture

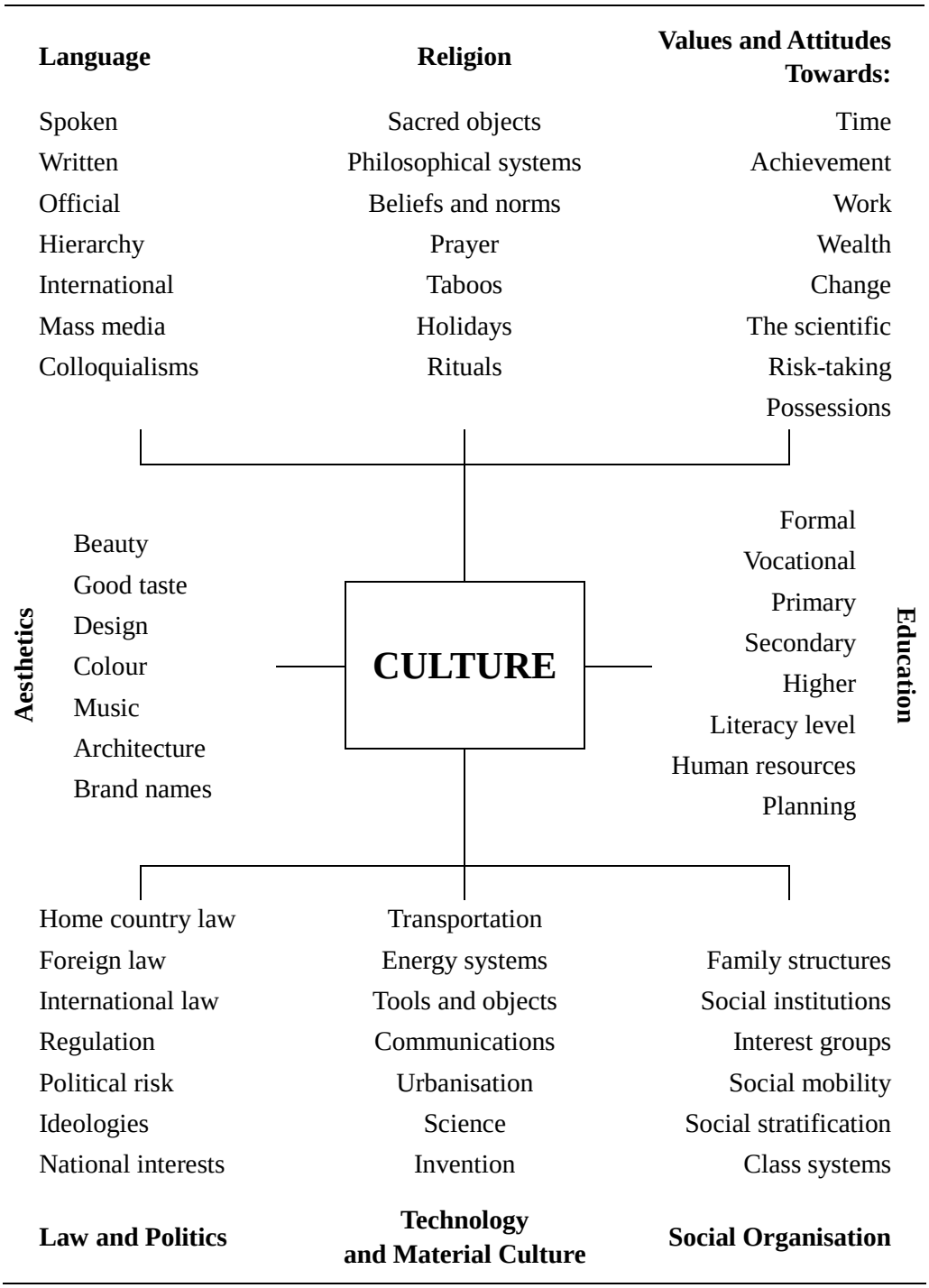
Culture is the shared values and beliefs of a society – its "design for living". However, with such an all-embracing issue as this, precise definitions rarely give usable meanings. Thus, within the culture

of most societies, there are almost always a variety of different "subcultures" – for example youth culture, student culture and so on.

Culture is learnt and the main force for transmission of whatever type of culture is the reference groups to which individuals belong. In this way, therefore, culture may also be thought of as the way in which people interact with each other in a group that shares some common sense of belonging.

One of the reasons that culture is so difficult to define is because it has so many elements that interrelate and change over time. One way of analysing it is to seek categories of significant elements as in the following diagram.

Figure 4.1: Elements of culture



You can probably add a number of other elements each of these categories, or even as sub-divisions of individual elements themselves. To illustrate the complexities involved, consider language. This is often a first consideration in looking at an international market. However, not all countries are linguistically homogeneous – India or Nigeria, for example, comprise a few hundred subcultures, each with its own language or dialect and who communicate only in a national context with a common language. In a business context, this situation creates further complexities by the need translation and, hence the communication becomes vulnerable to distortion.

There have been many attempts over the years to devise a method of testing for cultural significance across countries. The 72 cultural "universals" devised by Murdock (1945), listed below, identify elements that can be found, in some form, in all societies.

Figure 4.2: Common cultural elements

- Age grading
- Athletic sports
- Bodily adornment
- Calendar
- Cleanliness training
- Community organisation
- Cooking
- Co-operative labour
- Cosmology
- Courtship
- Dancing
- Decorative art
- Divination
- Division of labour
- Dream interpretation
- Education
- Eschatology
- Ethics
- Ethnobotany
- Etiquette
- Faith healing
- Family
- Feasting
- Fire making
- Folklore
- Food taboos
- Funeral rites
- Games
- Gestures
- Gift giving
- Government
- Greetings
- Hairstyles
- Hospitality
- Housing hygiene
- Incest taboos
- Inheritance rules
- Joking
- Kin groups
- Kinship nomenclature
- Language
- Law
- Luck superstitions
- Magic
- Marriage
- Mealtimes
- Medicine
- Modesty concerning natural functions
- Mourning
- Music
- Mythology
- Numerals
- Obstetrics
- Penal sanctions
- Personal names
- Population policy
- Postnatal care
- Pregnancy usages
- Property rights
- Propitiation of supernatural beings
- Puberty customs
- Religious rituals
- Residence rules
- Sexual restrictions
- Soul concepts
- Status differentiation
- Surgery
- Tool making
- Trade
- Visiting
- Weaning
- Weather control

Culture and Business

Comparisons of culture by identification of the differences and similarities in these elements is the most effective way of utilising such a broad range of variables. For businesses considering international markets it is essential to be aware of these cultural differences.

(a) Self-reference criterion (SRC)

It is very easy to use one's own cultural experience and values when viewing other people and cultures. In fact, it is almost impossible not to. In international business, though, the ability to think about other cultures from a culturally neutral standpoint can be very useful. It is the key to being able to identify differences in behaviour, markets and systems resulting from differences in culture and thus understanding the requirements of trading with and within another culture.

In 1966, Lee used the term "self-reference criterion" (SRC) as describing the approach of judging other cultural values and practices based upon ones own cultural standpoint. He went on to suggest a four-step approach to avoid it. The steps are:

(i) Define the situation, problem or goal in terms of the home country cultural traits, habits and norms.

(ii) Define the situation, problem or goal in terms of the foreign culture traits, habits and norms.

(iii) Isolate the SRC influences in the definitions and examine them carefully to see how they complicate consideration of the issue.

(iv) Redefine the situation, problem or goal without the SRC influence and derive a specification or solution which is appropriate for the foreign market.

Lee's approach is a logical way to reduce cultural difficulties. However, in practice it is quite difficult to be sure that step (ii) is carried out accurately. Accurate definition of problems in terms of a foreign culture needs a good knowledge of that culture. Without this it will be far too SRC biased and may result in inappropriate actions – for example, offensive or misleading brand names being used and irrelevant product features being promoted.

(b) High and low context cultures

In communication, some information is transmitted by spoken and written language and some by the context or setting within which the language is used. The relative importance of these two means of transmission within a culture can have important consequences for business communications.

Using this criterion, it is possible to classify cultures into:

- ***low context cultures*** – those where most information results from the language itself; and
- ***high context cultures*** – those where much information is communicated by the context within which the communication takes places.

We can place societies into these two broad categories as a guide to the use of communication – for example:

High Context Cultures	Low Context Cultures
Japanese	German
Mediterranean	English
Asian	Scandinavian
Arab	American

The importance of this distinction can be seen if we consider some of the facets of business communications and processes outside of the purely written or spoken word.

(i) Body language

This is a key element of oral communication and may serve to confirm or refute the message conveyed as well as giving information about the understanding and attitudes of the participants. Its importance can be magnified when communicating in a different culture from one's own, when the role and significance of the messages conveyed by body language may be also be different. In high context cultures, adherence to particular norms of behaviour and appearance considered appropriate to the setting within which personal interactions take place can be much more important than in low context cultures.

(ii) Time

Consider the following questions:

- What is the importance of punctuality for meetings?
- Is late arrival deemed to be discourteous?
- Are meetings well planned and do they run to schedule?

In a high context culture, establishing mutual understanding and developing friendship are seen as highly important. Time constraints will not necessarily take precedence over this and, therefore, it may be quite normal for meetings to overrun or to start late, or for individual punctuality not to be considered particularly important. In contrast, these norms of behaviour are likely to be a sign of inefficiency by participants from a low context culture.

(iii) Space

Space should be looked at in two ways; physical space and personal space – for example, does physical space confer status (in, say, office size) and how close is it acceptable to get to people? Again, these elements are culturally conditioned. In high context cultures, for example, it is more normal for there people to feel comfortable close together and distance between participants may be a sign of coldness.

(iv) Friendship

In high context cultures, deals often relate more to the people that you know and, therefore, social interaction and developing friendships is a key aspect to business. In low context cultures – the UK and US are good examples – friendship may be useful, but it is the contractual quality of the deal that is all-important.

(v) Contracts

The way in which contracts are negotiated differs. Lengthy haggling is normal in high context cultures and various inducements to purchase, which could be thought of as bribes in the US and UK, may not only be acceptable but also expected.

The way in which contracts are interpreted and delivery monitored also varies. In high context cultures, it is expected that friends will help each other out. In low context cultures it is more likely that lawyers will be brought in to argue interpretation and resolve difficulties.

These issues highlight the need for the international marketing manager to be aware of the dissimilarities in an international market. We must remember, however, that it is as important to identify the similarities and to ensure that best advantage can be gained from them.

(c) The cultural sensitivity of products and services

The products and services offered for sale in a particular society, and the way in which they are offered for sale, have to be acceptable to that society. In the main, consumer products are more culturally sensitive than business-to-business products, and those that are closest to the core beliefs of culture are the most sensitive of all. Often these relate to family and religion gatherings.

Food is particularly culturally sensitive because it has strong symbolic values which have been reinforced from our youngest days within a family. For example, in the UK, although the traditional Sunday lunch is much less usual nowadays, it still conjures up for British people a set of images that will cover the food served, the time it is served, the formality of the proceedings, etc. In contrast, a comparable meal in say France, a country quite close to the UK, will have significant differences – the time, the food, the drink, the length of time it takes to finish the meal and the acceptable behaviour of children. Pork is probably an extreme example of a food product that carries strong taboos in some cultures – for Jews and Muslims it has particularly offensive overtones and they will not eat it. Other religions also specify acceptable and non-acceptable foods.

Thus, when we look at products for an international market we must try to estimate how different cultures will view those products. Note, though, that newer products to the market, such as consumer durables, are invariably less culturally sensitive.

B. LEGAL FACTORS

The legal environment within which international business operates comprises three elements:

- ***Home country law*** – this defines what is considered by the home culture to be acceptable behaviour both at home and in dealings with a foreign country.
- ***Host country law*** – this defines acceptable behaviour within the country in which you wish to trade.
- ***International law*** – there is no international legislative body but there are a series of conventions, agreements and treaties, the enforcement of which relies on national sovereignties.

In light of this the international business must be aware of which jurisdiction will apply. Inevitable conflicts will emerge which may give rise to not only practical problems, but also moral issues as the legal environment in a foreign market conflicts with the cultural values of the home country.

There are also three main types of legal system operating in the world – common law, civil or code law and Islamic law.

- ***Common law*** – This system of law, used in the UK, the United States and Canada, is based upon tradition and on legal precedents. Laws are passed by government, but are then interpreted by the courts. The interpretation of the law then becomes the legal precedent for similar cases in the future.
- ***Civil or code law*** – Civil or code law is based upon laws that are written down. It is usual for there to be three different written types of law – commercial, civil and criminal. The aim in code law is to develop an inclusive set of written codes that will cover all possible situations.
- ***Islamic law*** – This type of law, based upon the Koran, incorporates social and religious obligations in addition to legal duties. An important element in Islamic law is the achievement of social justice. One feature of Islamic law that shows the difference between it and common and civil law is that it is unlawful to charge interest on loans.

The Law and Business

Legal factors provide the regulatory framework within which international business must operate and the legal system applying to business in a particular country has an important influence on many aspects of international trade – for example:

(a) Regulation of contracts

- The establishments of the legal rights of the buyer and the seller.
- The establishment of the terms and conditions between agent and principals.
- The mechanisms for the resolution of disputes regarding both the appropriateness of the quality of the merchandise (and so on) in respect of exported goods and responsibilities of agents.

(b) Regulation of the business environment

Legislation can condition what companies can and cannot do, including:

- export/import controls, tariff/non-tariff barriers and competition controls;
- pricing controls – for example, resale price maintenance and price increases;
- the registration and enforcement of trade marks, brand names and patents;
- product liability and product safety;
- advertising and sales promotions – what can be promoted and how it can be promoted;
- labelling;
- environmental issues – for example, Germany has strong laws regarding excess packaging which makes manufacturers responsible for the responsible disposal of extra packaging materials.

It goes without saying that businesses must be careful to operate within the laws and regulations of the countries in which they are trading. This is particularly important when the business is trying to establish a global approach and, therefore, wishes to standardise operations and marketing as much as possible. So, for example, in some countries certain types of advertising may be illegal and the business cannot apply an approach used elsewhere in the world. Countries often differ considerably with regard to, for example, competition policy and price legislation. In the same way there is

considerable difference throughout the world with respect to what is considered legal when offering "gifts" to organisational and government buyers.

Even countries which, in all other respects, appear to be very similar and are even supposedly bound by trading agreements because they are members of a trading bloc can in fact be very different when it comes to legislation. So, for example, Germany has much stronger legislation with regard to green issues than many other members of the European Union. For example, all packaging in Germany must be recyclable and the supplier is responsible for any pollution caused. This is very different to legislation operating in, say, the UK or France.

C. ECONOMIC FACTORS

The economy of any country is the end result of the production and the distribution of wealth. As we know this is a continually moving feast, but whereas in some countries the fluctuations are small over a prolonged period of time, in others changes can be great and almost overnight.

Before we look at some of the indicators of the economic environment of a country, we should briefly note some of the underlying resources that influence it.

Economic Resources

The three factors of production – labour, land and capital – are the key resources of economic activity. We shall interpret these factors in a broader sense here in as much as they represent important considerations for business.

(a) Population

Since the 18th century the world has undergone a population explosion which has impacted on all aspects of life. In economic terms, population is an important factor. The availability of labour is an essential resource in the manufacture of goods and services, whilst at the same time the population as a whole provides a market for the goods and services produced.

However, it is not just the size of the population which is important but also its age, sex and geographic distribution. If, for example, as is the case in most advanced countries, there is an increasing proportion of dependent population – i.e. the old, the young and the unemployed – then resources will be channelled into supporting them and consequently economic growth will be slow.

(b) Natural resources

A country's ability to generate wealth will be linked not only to its population but also to its geography. This conditions not only the availability of natural resources – land, water, minerals, etc. – but its ability to exploit them productively. Thus, the climate and terrain can be important in respect of the ability of a country to develop, for example, forestry as a productive industry and to develop effective transport systems (including port facilities).

(c) Infrastructure

The ability of a country to utilise its labour and natural resources will be influenced by its infrastructure. By this we mean the stage of development of its housing, transport, communication, energy, etc. systems.

These elements are very much linked to the existing stage of economic development and you will remember, in Study Unit 2, that we classified countries into three groups – less developed countries, newly industrialised countries and highly industrialised countries.

Economic Indicators

These are factors which provide information about the economic development and conditions in a country.

(a) Income

When we consider the economic factors, the distribution of wealth is perhaps the key consideration in the selection of target markets.

Countries can be considered in terms of their total income, or gross national product. Using such a league table, the US, Japan and Germany have the top positions. Indeed, the concept of the importance of the Triad is based upon the large size of the GNPs of the US, Japan and Europe.

From an individual company point of view, the total income figure for a country can be used as a rough guide to a specific market size. Thus, a country might already be in the maturity phase with its markets reliant upon low levels of replacement sales. In other less developed countries, with lower levels of GNP, the market might be growing rapidly with initial purchasing. For example, the electricity supply industry in the top GNP countries is well established, but in countries with lower levels of GNP but with high growth rates, the demand for electricity might be increasing rapidly – this would create a strong growth in the market for electricity supply equipment and transmission in those countries.

In most instances, though, companies are more concerned with market segment(s) rather than the total market in any one country. Because of this, companies will be more interested in the GNP per person or per capita than the grand total. Breaking down GNP per capita further, companies will be interested in the level of disposable income after various commitments of taxes, health and social security payments and other major payments have been made. This is usually a better indicator of available expenditure, in the majority of consumer markets, than GNP per capita. If this approach is used, considerable market segments can be identified in countries that are often thought to be quite poor. For example, in India there is an affluent middle class with a considerable disposable income. The total size of this segment is larger than the populations of most other countries in the world.

Certain general relationships exist between income levels and expenditure patterns. For example, the amount of income spent on food, expressed as a percentage of income, is higher in poor families and in poor countries than it is in richer countries. There are variations in the general rule. For example, in Japan, almost 20% of consumer spending is allocated to food, compared with 15% in the US, 13% in Germany and 11% in Britain. The explanation for the high spending on food in Japan is partially based upon the high prices of food there, caused by protectionist economic policies in Japan to support local agricultural products. In part, though, expenditure on food is influenced by culture – food in Britain is given a comparatively low priority, whereas in Japan and France food is seen to be more important. This results in higher consumer expenditure on food.

(b) Inflation

This is a major influence in most countries. In some countries, for example the UK, one of the main reasons explained by government for economic decisions is a desire to control inflation to a particular target level. In other countries, inflation rates are so high that pricing and other decisions have to take account of the constantly increasing price of goods and services.

The Asian countries of China, India, South Korea and Taiwan have all achieved rapid growth during the past decade with inflation rates usually below 10%.

Latin and South America is different and here there are several stories to tell. Some countries, for example Brazil which has sometimes experienced inflation rates in the order of 2,000%, have a long history of uncontrolled inflation. Argentina had very high inflation rates in the 1980s but has now brought the rate down to 11%. Mexico, whilst never as out of control as Argentina, has succeeded in bringing its inflation rate down from over 100% to under 10%. Chile has maintained the best record – its inflation rate never increased much above 20% in the 1980s and is now down to around 12%.

(c) Capital investment

This is associated with economic growth. Recently, countries in Asia have been spending a higher proportion of their Gross Domestic Product (GDP) on fixed capital investment than other countries around the world. At the beginning of the 1990s, financed mainly by the high level of domestic savings, the Asian countries of South Korea, Thailand, Singapore, China, Malaysia and Indonesia all invested 30% or more of their GDP into fixed capital. Latin American countries typically invested around 20 – 25%.

(d) Government policies

Other economic influences that can be important are the level of government budget deficit or surplus.

The level of official reserves of foreign currencies and gold and special drawing rights in the International Monetary Fund shows a country's ability to meet its external obligations. If reserves are going down rapidly, this will have an almost certain downward effect on the value of that country's currency. Declining official reserves shows a decline in confidence in the country's economy. It could be linked to deteriorations in the country's balance of trade and the balance of payments.

Government decisions taken to influence economic performance by, for example, reducing inflation or to stabilise the foreign exchange rate, will affect the level of personal and corporate taxation. If taxation increases, other factors remaining constant, market sizes will decrease in the consumer and most business markets. On the other hand, government markets will increase to reflect the higher influence of the government in the total market-place of that country.

D. POLITICAL FACTORS

In an ideal world, companies would like to have a political climate that does not change and is supportive to business interests. They would like to see policies which lead to:

- Low inflation rates
- Steady market growth
- Low taxes on company profits
- No restrictions on the ability to repatriate profits
- No restrictions on local content
- Support for a market economy
- A lack of government intervention, for example no controls on price levels or profit levels
- The encouragement of inward investment by foreign companies.

However, it is unlikely that this situation would persist in any country.

From a business point of view, the major political problem is likely to be instability. Instability may arise through frequent changes in the ruling political party or elite, and/or through frequent changes of policy by a stable ruling political party. If the political situation is one in which the environment surrounding the company is predictable, companies can develop and implement international business plans with some confidence. If the government changes direction frequently, medium- and long-term planning becomes very difficult and companies will feel forced to adopt short-term, highly pragmatic approaches.

Note that, even in politically stable countries, democratic elections which could change the ruling political party take place every five years or so. When a new party takes power, there is likely to be a measure of uncertainty whilst it settles into the job of running the country and the effect of new policies is awaited. Even if the same political party is in power for many years, there will be a variety of political and economic issues that will cause it to make changes in political and economic directions, and most governments pass laws which affect market opportunities from time to time.

Other forms of stable government may create problems for business – for example:

- where the political party in power does not support business interests, as was the case in most of the ex-COMECON countries from the end of World War II to 1989; and
- where the ruling power base is autocratic and is not subject to various checks and balances to prevent the abuse of power – the regime of Idi Amin in Uganda was an unfortunate example of the excess that can result from autocratic political power.

Stability, though, is not the only issue of interest to business. It is also concerned that governments take political and economic decisions that do not cause the economy to decline or become less profitable for companies. For example, many Latin American countries were not able to prevent runaway inflation in the 1980s, and other governments have acted in ways which conflict with business interests by such policies as increasing corporate taxation or using price controls to try and control inflation.

There have been various attempts to identify the level of risk inherent in a country. One such approach is the Business Environment Risk Index (BERI) which was started in the US in 1972. In the BERI ratings, countries are evaluated on 15 economic, political and financial factors on a scale from zero to four. The factors that relate most strongly to political areas are political stability, attitudes to foreign investors, nationalisation, bureaucratic delays, and currency convertibility. Scores on the BERI scale are calculated out of 100 and a score of 80 or more indicates an acceptable level of risk. However, scores of 40 or less suggest that the level of risk is probably unacceptable and companies should think carefully before commencing business in countries with this sort of score.

E. TECHNOLOGICAL FACTORS

You will be well aware that there has been a rapid growth in the speed of technological advancement over the recent decades. One of the remarkable features of this has been the way in which access to advanced technology has spread from one or two countries to many countries around the world. It is now not unusual to see people, without what many cultures would perhaps consider the essentials for existence, using computers in offices and shops, communicating by mobile telephone and watching television programmes via satellite. Wide variations in technology between countries are less a feature of the international environment than is the case with legal, economic and political factors.

This has partly been the result of the development of multinational and transnational companies and partly the result of government intervention.

- The practice of multinational companies basing their operations in those countries around the world that provide the best returns has increasingly meant that countries with low costs for labour and for factory and office sites are being used to produce components and sometimes the final assembled product. As part of this process, a great deal of technology transfer takes place. Many NICs and LDCs have benefited from the acquisition of technological and production-process know-how.
- In addition, governments in many countries have encouraged the development of "high-tech" industries and investment in education and training to ensure a competent, skilled workforce as a means of accelerating economic growth and to reduce levels of unemployment..

The availability of technology is, therefore, less based on a few countries, although it would be true to say that some countries have a much wider range of advanced technology than others.

There are a number of issues in respect of this spread which have important consequences for international business.

Availability of Information

The developments in communications – and by that we mean personal communications, transport and the media – mean that we live in a shrinking world. Information about events almost anywhere in the world can be obtained almost immediately by anyone anywhere. For example, when Perrier experienced a pollution problem at the bottling plant in France, this was flashed all over the world within 24 hours, and by the next day, shelves in supermarkets and retailers throughout the world had been emptied of Perrier products.

Consumers can access information now at the touch of a button making it much easier to, say, compare prices. This puts a premium on information, and particularly on its access, control and analysis.

A number of developments arise from this:

- satellite and cable television has opened up the number of ways in which people across the world can receive information – and particularly advertising – with minimal control over content by individual states;
- companies need to pay particular attention to the need to get their own interpretations across to the public in the face of competing analyses – and this has given rise to the phenomenon of "spin doctors" attempting to manage the way in which events are reported and perceived;
- businesses need to exploit a wide range of technologies in communicating and conducting operations.

Technology Life Cycles and Development Costs

New technologies and products can be extremely expensive to develop – for example, a new pharmaceutical product will cost millions of dollars to bring to the market, and a new model of car for mass production will entail a huge amount of investment. On the other hand, the speed of technological and market change means that technologies and the products they underpin have ever shorter product lifecycles before the next generation of technology and products is developed.

The high cost of research and development to produce the next generation of products coupled with shorter technology life cycles has given an impetus to two developments.

- One is the need to market products to more and more country markets in an attempt to justify and recoup the high costs of research, development and product launch. In many products, the

market in any one country is less and less likely to be sufficiently large to achieve a break-even position. This has resulted in regiocentric and geocentric planning becoming more relevant.

- The second development is the use of alliances, of various types, in an attempt to share some of the costs of product development. Often, businesses are not be able to recoup the high costs of investment in new products and technologies before they are made obsolete. As a result, we are increasingly seeing the joint development of technologies and new products between different companies throughout the world so that investment costs and risks can be shared. So, for example, the Advanced Photography System was developed through the joint efforts of the leading companies in this market including, for example, Kodak, Fujitsu and Sony. In the future, we can expect to see even greater co-operation and collaboration on an international basis by companies to develop new technologies.

The Internet

It has been widely predicted that the Internet is destined to change virtually every facet of our lives, including the whole nature and operation of business. Its major impact in respect of international business is that it enables the process of buying and selling across international boundaries without any reference to the traditional methods of conducting such transactions – face-to-face contact, use of agents and intermediaries, offices and facilities abroad, etc.

The characteristics of the Internet are such that:

- It facilitates global marketing for the smaller companies which in the past perhaps have faced major disadvantages compared to their larger counterparts.
- It enables customers to compare and contrast competitor offerings much easier and on a much wider basis than before.
- It is a cost-effective and convenient way of purchasing products and services for both consumers and business-to-business customers.

Of course, none of this will happen if customers do not have access to the Internet, but increasingly they will. The costs of computers and access to the Net are dropping significantly. Further, technological developments mean that in the future, access will be through other means, such as conventional digital TVs and mobile phones. More and more customers in the future, therefore, will be able to access the Net.

The use of the Internet by businesses is growing rapidly – both for advertising their products and services and for actually selling them. Virtually all the large multinational companies have now developed web sites, but interestingly enough, it is the smaller, newer companies who have been the quickest to realise the potential of the Internet for commercial purposes. Companies like Amazon, an Internet book sales company, which has grown from nothing in just two or three years to being one of the largest in the market, all through Web-based sales.

There is no doubt then that the Internet will give rise to some of the major opportunities and threats for international business in the future. It is also likely to impact on the whole nature of marketing operations ranging from access to, and the use of, data through to the concepts of market segmentation and targeting, and the way in which elements of the marketing mix are applied.

F. THE "C" FACTORS

In the same way that the letter P is used to help us remember the elements in the marketing mix (product, place, promotion and price), a number of writers have used the letter C to identify various elements in the analysis of international markets.

Country

The concept of the country is significant in international business. This might seem rather self evident, but it is important to understand how the concept is used and what its limitations are.

Companies often use countries both as a unit of analysis and as a basis for their organisational structure. In terms of analysis, in many ways the boundary between one country and the next country changes markets. We often find that the laws change, the types of retail outlet are different, the types of tax paid on income and on expenditure are different, newspapers, radio and television are different. In addition, the spoken language may well be different, although in the border areas it is not uncommon for people to speak both the languages of the neighbouring countries. Thus, it is very often the case that there are many differences in the business environment caused by the different rules, regulations and customs that relate to one country and not to the next.

It is important, however, not to fall into the trap of assuming that a country constitutes a homogeneous market. We have already used the example of India, where there are many different languages, considerable divisions in the society caused by the caste system and a large proportion of wealth is owned by approximately 5% of the population. Consider also the United States of America. They may be united, but many states have their own laws and very different cultural values – consider the difference between those living in multicultural New York State and those living in the deep south.

Additionally, in some parts of the world, the development of trading blocs has started to mean that companies need to consider trading blocs or world regions as another basis for their analysis. For example, Japanese and US companies might need to develop analyses based upon the European Union as well as the individual countries within the EU. In addition, companies might change their organisational structures to allow a pan-European organisation and culture to develop. A European head office might be started in Paris, Brussels or perhaps London.

Finally, in some ways, countries and country boundaries may increasingly not be the best way of thinking about market boundaries and target markets for the international business. As we shall see in later study units, it may be more useful to look for similarities and differences with respect to, for example, customer needs and wants, in order to group customers and markets rather than grouping them by country.

Currency

One of the major differences between countries – and one that keeps the concept of the country strong in business terms – is that each country has its own currency. Thus, neighbouring countries, which may be similar in many other respects, will have different currencies.

This is a significant issue for international business. At its lowest level, the problem is simply the need to change one currency into another in order to effect payment for international transactions– thus, if you export products to a company in Argentina, your customer will normally only have pesos to pay your invoice and either you or your customer will have to exchange currency so that both parties end up with currencies that are acceptable to themselves. The other, more significant, problem is that currencies change values. For example, over the past ten years or so, the pound has exchanged at rates varying from approximately £1 to $1 to £1 to $2, which is an effective change in value of 50%

from the strong sterling position of gaining two dollars for every one pound sterling. Variations in exchange rates cause considerable problems for business.

In terms of the financial implications, companies need to take steps to manage the risk that variations in the exchange rate will cause the value of payments due in a different currency to fall in terms of their own domestic currency. There are number of measures that can be taken – for example, buying foreign currency forward at a fixed rate – in order to remove the risk and obtain certainty about its future income and profit levels. We shall return to this when we consider international finance later in the course.

Large international companies often try to develop their international operations to avoid the need to exchange currencies. If they can exchange products and services between different subsidiaries in different countries, they can minimise the amount of currency that needs to be exchanged. Most of the exchange can be handled internally within the company accounting system.

Changes in foreign currency exchange rates can also influence pricing decisions. Over minor exchange rate fluctuations, the company can invariably adjust its profit margins in order to maintain a constant price to the customer. However, if the fluctuations are considerable, the company might need to change its business strategy radically. The problems arise when its own currency is appreciating, therefore making its products more expensive in other currencies and, hence, less competitive with other producers, principally local ones which are not affected by exchange rates. One solution would be to drive down costs in order to avoid increasing prices – for example, embarking on substantial cost reduction programmes in its home production or finding different distribution channel arrangements with lower distributor margins. Alternatively, it might attempt to develop a more expensive image and positioning to help to justify the higher price.

As we saw in Study Unit 3, regional trading blocs may attempt to minimise some of the problems caused by different currencies by adopting common rules for, say, fixing exchange values between member countries. In the case of the European Union, we have seen the introduction of a common currency, the Euro, in order to reduce some of the problems caused by volatile currencies and exchange rates.

Competitors

In international markets, competition is often more difficult to manage than in the home domestic market. The reasons for this include:

- In international markets the company often has a lower market share, sometimes very much lower, than in the domestic market. This results in a less powerful position. It also results in costs which are relatively higher – because of the lower scale of operations, activities such as marketing research or advertising are more expensive per unit of product sold.
- The development of more international companies means that, in any one market, the number of companies looking for a share of that market is increasing. As business looks beyond its domestic markets, companies from all around the world are becoming more world regional and global in their business strategies and in the co-ordination of their strategies towards competition.
- Companies in the NICs are becoming more and more successful in their own markets – developing products and services which can compete with foreign multinationals on most terms and often undercutting them on price. The more successful such companies become, the more difficult it is for international companies to retain their share of the market. Further, many of these companies are themselves looking to international markets for growth – for example, the Proton car from Malaysia.

When added to the difficulties of obtaining high quality information and the barriers resulting from cultural differences, these factors make it increasingly difficult to compete successfully with competitors in non-domestic markets. Furthermore, some competitors will have advantages resulting from lower operating costs and/or from currencies that are depreciating.

G. THE USE OF SLEPT AND C FACTORS IN INTERNATIONAL BUSINESS PLANNING

Whilst essentially straightforward, the information covered by the SLEPT and C factors is extensive. However, understanding the factors is only of value if they are applied to assist the organisation deciding "where to go" in international business planning. Successful business strategy, whether at home or abroad, is about developing markets for products and services, and this can only be effective if it is applied to meet the specified needs of a target group of customers – i.e. individuals making their purchasing decisions against the background of a dynamic macro environment.

The overall importance of the SLEPT and C factors is that together they constitute the macro environment within which business operates.

Cross Cultural Analysis

Cross cultural analysis is a means of bringing together the factors by considering them against a number of key business elements.

(a) Needs and wants

Here the key question is what needs or wants does the product or service satisfy at the moment in the particular market? To answer this, the SLEPT and C factors need to be assessed against the particulars of the product in question.

If the answer is not readily apparent, or there is none, then the business needs to consider either how the product should be presented to satisfy current needs or wants – for example, should the product be made cheaper, does it need a more comprehensive and locally responsive level of customer service, etc. – or whether the product itself needs to be modified.

(b) Patterns of buying behaviour

Here the key questions are who buys, who influences the buyer and who uses the product?

The answers here are likely to be strongly influenced by social and cultural factors such as the roles of men, women and children. Note, though, that in all societies, cultural patterns change over time and these roles are themselves changing in many countries. We need, therefore, to try to establish how deeply culturally ingrained are buying behaviour patterns – for example, who goes shopping and how much influence each participant in the buying process has in the final purchase decision.

We shall consider buyer behaviour patterns in more depth in the next study unit.

(c) Cultural influences

Using high and low context culture and the cultural sensitivity of products, we can look to see if there are important cultural influences that relate to the product or service and the way in which it is presented. Big context differences between markets will almost certainly point to differences in the way the product will be perceived and the way it might be used. It is also important to consider the way in which the product relates to values in respect of religion,

family, morality, work and recreation. If these values are likely to affect the way in which the product is viewed, marketing plans will need to be amended in some way.

(d) Methods of communication

We need to know how differences in the SLEPT and C factors will influence the effectiveness of marketing communications – advertising, public relations, sales promotion and packaging. What languages should be used, what sort of messages seem to work best, is advertising an accepted method to communicate persuasive messages?

Again, cultural values and context will be significant – for example, in the US, many advertisements feature a direct hard-sell style, whereas in Japan, advertising is much more likely to develop images and in the UK, humour is an accepted form of advertising. The economic and technological framework of the country will also influence communication through the ways in which the message may actually be delivered to the target market.

(e) Methods of selling

Here the main concerns are what types of salespeople are likely to be effective – do they need to come from a particular race or religious background, what language(s) do they need to speak, etc.

Social and cultural factors will predominate. Thus, it is probable that considerable cultural training will be required before a salesperson from a low context culture such as the US will be successful in a high context culture such as Japan.

(f) Methods of distribution

We need to be aware that entrants into a country market are frequently unable to put together their ideal distribution channel. Other companies will have established distribution arrangements and, therefore, there might not be space for the new entrant. In Japan, the particularly closely knit distribution systems operating between several layers of wholesalers and the retail level make it especially difficult for non-Japanese companies to establish effective working contacts with distribution channel intermediaries. We have to consider how customers view different types of retailer, wholesaler, agent and distributor.

Use of Interpreters

One means of bridging the social and cultural divide is to use interpreters to aid communication.

Interpreters are very useful in international business because of the need to find a common language in situations where people are not fully conversant with the different languages involved. They are, therefore, widely used to translate from one language into another in meetings, conferences, exhibitions and trade fairs, sales negotiations and factory visits. (Note that interpreters are used in spoken language situations – translators will be used in written language situations.)

The following points need to be understood about use of interpreters:

- 100% accurate interpretation of one language into another is rarely possible, no matter how much that may be expected by the participants. Misunderstandings will be limited when high-quality and reliable interpreters are used. The more that they know about the product, the industry and the technology used, the more likely they are to be accurate.
- It is common for certain words or phrases to be impossible to translate without a complicated explanation of the cultural context in which they are used. For example, in Japanese, the word “no” practically does not exist, and in some situations the word “yes” can in fact mean “no”. A straightforward interpretation of the words will result in misunderstanding.

It is clear that translation and interpretation often cannot be avoided in international business. However, it must be remembered that changing the language does not necessarily mean the correct messages will be transmitted. It is important to manage the process of translation and interpretation to limit the extent of poor and incorrect communication.

Identifying Opportunities and Threats

Businesses must not only be aware of the SLEPT and C factors, but ideally must be able to forecast and anticipate them. It is these factors, or rather trends and changes in them, which give rise to the major opportunities and threats which the international business must take account of. In fact, being able to anticipate and respond to these trends and changes is increasingly the key element in competitive success for the international business. In particular, adaptation of marketing strategies and plans through the marketing mix, in order to achieve a "strategic fit" with the environment, is essential. We must remember, however, that achieving this is much more difficult in international business because of the following aspects of the environment:

- The international business is faced with much more diverse environments than the purely domestic marketer.
- Unlike the domestic environment, often these environments will be relatively unfamiliar to the business.
- International business environments are generally more dynamic and therefore difficult to predict.

The business therefore needs good systems of marketing research and intelligence coupled with an awareness and sensitivity to different environments. Finally, sensing opportunity and threats and responding to these requires good forecasting systems and flexible systems of company operation and structure.

H. SOCIAL RESPONSIBILITY AND INTERNATIONAL BUSINESS

In addition to the conventional SLEPT and C factors, recent years have seen the growth of a number of other macro-environmental issues which the international business must be aware of and respond to. Of particular significance has been the growth in importance of ethical/social and green (environmental) issues. Related to these, and indeed partly responsible for their growth in importance, has been the emergence of often very highly organised and vociferous pressure groups.

Ethical, Social and Green Issues

Concern with social and ethical aspects of international business and marketing has grown as customers have become more aware of their possible harmful social implications and the, admittedly and thankfully relatively small, amount of unethical practices by some businesses.

Of particular concern is the exploitation of developing countries by multinational companies through the depletion of their natural resources for little return, the degradation of their environment and the payment of low wages for the production of products which sell in developed countries for very high prices. The global tobacco companies have been criticised for switching their marketing efforts from the developed countries, where cigarette sales have been falling, to the newly emerging industrialised countries who have been persuaded to increase their purchases of cigarettes.

The size and power of the multinationals has, in the past, enabled unscrupulous companies to get away with socially unacceptable and unethical practices. However, this is changing – partly as a result of legislation by both home and host countries, partly as a recognition of the public relations problem that such practices can pose to companies, but most importantly because of changing social values, with customers throughout the world now demanding that companies operate socially and ethically acceptable business policies and programs.

Green issues, too, have become an important concern for customers throughout the world. We have already referred to the depletion of the world's resources through the worst excesses of some of the multinationals, particularly in industries such as mining, forestry and oil extraction, but governments are increasingly requiring that companies operate and implement policies which do not harm the environment. Similarly, customers are increasingly demanding green products, produced with green credentials.

For the company unable, or unwilling, to respond to this increased awareness of social, ethical and green issues, consumer demands for socially responsibility represents a distinct threat. However, the more astute companies have recognised that, in fact, this represents a distinct marketing opportunity. Such companies have responded to this growth in awareness and the emergence of pressure groups by introducing business policies and strategies which are more socially and ethically sensitive and products and services which are distinctly green in their credentials. So, for example, increasingly timber companies operate environmentally friendly policies of only producing and marketing timber from managed forests.

Pressure Groups

There is no doubt that pressure groups of one sort or another have been important and influential in encouraging companies to be more socially/ethically and environmentally responsible. For example, Shell recently proposed to sink a disused oil drilling platform in the North Sea leading, it was suggested, to potential significant levels of pollution. Only after concerted efforts by pressure groups, and in particular Greenpeace, were these proposals by Shell withdrawn.

Furthermore, these pressure groups are increasingly organising on an international/global basis so as to match the power of the global companies. We saw in an earlier study unit, for example, that the recent world trade discussions were effectively destroyed by the activities of a number of pressure groups who organised demonstrations to disrupt the talks. Moreover, these pressure groups organise themselves internationally through the use of the Internet. It is likely that pressure groups will continue to grow in importance with regard to the operation of international business, and that access to and use of communications technology will enable these groups to act quickly and powerfully to make their feelings known.

Study Unit 5

Understanding Consumer Behaviour

Contents ***Page***

INTRODUCTION

In this unit we continue our theme of exploring the environment of international business by focussing on the way in which goods and services are bought.

We start by considering the main types of buyer behaviour – consumer, business and government – and, in particular, highlighting the influence of culture in creating differences and similarities between buyer behaviour in different countries. The concept of high context/low context cultures is particularly useful in showing where major adjustments in approach might be necessary on the part of sellers.

In the second part of the unit, we further our consideration of the possible differences in customer behaviour by looking at how behaviour, and therefore marketing, might differ when considering countries at different stages of economic development. We shall take the three main stages we have examined previously – lesser-developed countries, newly industrialised and highly industrialised countries – and consider the market opportunities available and influences on the three types of buyer behaviour.

Note that this is only one basis in which countries can be classified and therefore analysed with respect to differences in customer behaviour. In other words, different ways of classifying countries will yield different insights into similarities and differences in customer behaviour between countries. So, for example, if we classified countries by the predominant religion in the countries, we would possibly gain a very different picture of similarities and differences in customer behaviour between different countries compared to using differences in stages of economic development.

A. CONSUMER BUYER BEHAVIOUR

Consumer buyer behaviour is concerned with the buying of goods and services by individuals and households for personal consumption. Consumers buy a large range of goods and services, although in general they are frequently much less well informed than business buyers at the point of purchasing the product.

Influences

The main influences on consumer behaviour are culture, social factors, personal factors and psychological factors.

We looked at culture in the previous study unit. It is useful to note, however, that culture is not specific to the international context, but rather a normal feature of all models of buyer behaviour. Culture is given a higher prominence in international business because it is a major cause of difference between one market and another.

There are certain aspects of these influences on the buying process that should be put under the spotlight here because there are likely to be differences in them from one country to another. You should note the following points.

(a) Social Class

In some countries, social class is very rigid; little movement up or down is possible.

(b) Family

The concept of the family varies from the narrow version of the family (parents and their associated children) to the extended family (including grandparents and other relatives) as is the norm in, say, Italy.

(c) Age and life-cycle stage

Consumer purchases are influenced by age and by the stage in the family life-cycle. Thus, a two-year old will have different requirements from a middle-aged person, and a 24-year-old person, married with young children, will buy with a different set of priorities when compared with a 24-year-old single person.

In different countries the age composition varies. A typical difference is that industrially advanced countries (such as Germany) will have ageing populations, whereas in lesser developed countries the population will have a much younger profile, with large numbers of babies and children.

(d) Gender

The roles and status associated with men and women vary within most cultures and between cultures. You need to be aware of these differences and of the way in which changes are occurring.

(e) Needs and motives

In many Western countries, customers share similar motives and motive hierarchies, such as the desire to succeed and belong and achieve social affiliation. These derive from Maslow's model of a hierarchy of needs, which has been very influential in the way consumer behaviour is considered. However, these are not consistent across cultures. So, for example, in some parts of the world, self-esteem needs are met before physiological needs.

The Consumer Buying Process

A typical way of considering the buying process is:

- problem recognition;
- information search;
- the evaluation of alternatives;
- the purchase decision; and
- post purchase evaluations.

This process describes the full rational decision making process which a buyer might go through. The extent to which a buyer will go through all the stages in a lengthy and deeply considered way depends upon the type of purchase. Thus, marketing theory usually distinguishes between three types of approach – habitual, limited problem solving and extended problem solving. A key distinction between these types is whether there is an external search for information. For example, the daily purchase of a newspaper, the infrequent purchase of a holiday or the major purchase of a new house have different levels of personal involvement and will span the range of approaches. Extended problem solving will involve external information through word of mouth, advertising, media, product information, salespeople and other sources of information.

Note, too, that not all recognised problems end up with a purchase decision – sometimes the consumer may change his/her mind during the process and decide to save the money or even buy a completely different product or service.

The consumer buying process is sometimes thought of as a "***one person, one buyer***" situation. On occasions, though, there is a "***decision-making unit***" at work. If you consider the purchase of toys at Christmas, the child will use the toy and the child might also initiate the purchase by asking for it. Parents might reject some requests (too expensive, looks dangerous, not educational enough, will

break easily, etc.) and will retain others. Parents might buy some toys, whilst others might be purchased by other gift providers, such as grandparents or godparents.

As with the influences on consumer buyer behaviour, the consumer buying process itself may be very different from country to country. Take, for example, the purchase of a gift for a wedding present. Different countries have different cultural attitudes towards gift giving and specifically differences towards gift giving to celebrate a wedding. In the United Kingdom, for example, it is common practice for the would-be bride and groom to provide a "wedding list" comprising items they would like to have purchased as gifts. In other parts of the world, however, this practice would be considered unusual and even distasteful. So, for example, in some cultures wedding gifts comprise mainly money gifts bestowed to bride and groom on the day of their wedding. Similarly, if we take an example of toy purchasing, in some cultures it would not be considered appropriate for children to have any say or influence on this process.

Again what we are stressing here is the fact that consumer behaviour is not the same in different international markets. Again, even countries which in many respects have very similar cultures and/or are geographically proximate, can be very different with respect to consumer buying processes. In fact, there still remains much research to do with regard to models of the buying process in different parts of the world, and it is useful to bear in mind that many of the different models of the buying process have been developed with reference to consumers in highly developed economies.

B. BUSINESS-TO-BUSINESS BUYER BEHAVIOUR

This type of buyer behaviour is sometimes referred to as industrial buyer behaviour, or organisational buyer behaviour. Well known writers in this area, Webster and Wind, define organisational buying as

"the decision-making process by which formal organisations establish the need for purchased products and services, and identify, evaluate and choose among alternative brands and suppliers".

The key elements in this process are as follows.

(a) Decision-making unit (DMU)

Various people are involved in the buying process within an organisation. Collectively they constitute the DMU or buying centre.

Within a DMU there are a number of roles – although this does not imply that each is held by a different person:

- Users
- Influencers
- Deciders
- Approvers
- Gatekeepers
- Buyers

This group, the way they interact and the processes through which they make decisions will be conditioned by their environment – the structures and culture within the organisation and the culture of the broader society. Thus, some organisations will be autocratic, with the decider being the central role, whilst in others it is more usual for all of the roles to have influence in the buying decision. Similarly, general cultural differences between societies – for example, in terms of deference to seniority – will influence organisational behaviour.

(b) Interaction between buyer and seller

It is quite usual in business-to-business buying for buyers and sellers to negotiate and influence each other in determining the form of the final transaction and other aspects of the interaction. Contrast this with your own personal influence as a buyer on the manufacturers of, say, chocolates or CD players.

It is particularly the large important buyers who have influence on sellers. These important buyers, such as Toyota for car components, will often contact sellers and negotiate influence over the way the product is made, how it is delivered, how it is priced and so on, in order to meet their requirements. This process is not, of course, one-way. Sellers will contact buyers and present propositions based on various groupings of the marketing mix, based around their assessment of the needs of the buyer. In the end, the final purchased product or service is usually shaped by the negotiations which take place between the buyer and the seller.

It is common for satisfactory initial contracts to be developed into a longer-term relationship between buyers and sellers.

In the 1960s and 1970s, there was a tendency for western firms to buy from whatever was the cheapest source of supply. However, more modern approaches to business-to-business marketing have been influenced by the success of the Japanese approach which, whilst still in its own way aggressive, is longer-term, evolving and more to do with developing a consensus. Most businesses now aim to select a few key companies from which to buy products and services and to develop long-term relationships with them. The benefits of this approach are to reduce the costs in switching from one company to another and to use the supplying company as an additional resource. The supplying company might hold stocks for the buyer (for example, as in just-in-time systems), carry out most of the quality assurance process (ensuring zero defects, total quality management, etc.) and even have a role in the buyers new product development process.

(c) Major types of buying situation

The numerous types of buying situation have been grouped into three ***buy-classes*** by a number of writers on business markets. The three buy-classes are:

- Straight rebuy;
- Modified rebuy;
- New task.

In international business, it is particularly valuable to isolate the buy-class. By doing this you can see how the buying process will differ and this will influence negotiation of the appropriate marketing mix for the product.

(d) Differences between international business-to-business buyers

As with consumer buyer behaviour, the international business needs to be careful not to assume that the processes of buying from other businesses, and the factors which affect them, are the same in every country – again they are not. Although the basic models of business-to-business buyer behaviour and some of the concepts outlined here (such as the DMU, buy-classes and so on) can be used to investigate the behaviour of business-to-business buyers in international markets, this process can be very different between different countries.

Again, the primary reasons for differences are likely to be essentially cultural factors, but also differences in the economic, political and legal factors may cause differences in business-to-

business buyer behaviour. Examples of possible areas where differences in business-to-business buyer behaviour in different international markets may be encountered include:

- Differences in approaches and attitudes to negotiation.
- Differences in approaches to searching for suppliers.
- Differences in the importance and nature of relationship marketing.
- Differences in attitudes towards gift giving.

C. GOVERNMENT BUYER BEHAVIOUR

Governments and other governmental institutions, such as local authorities and nationalised industries, are important buyers in most national markets. In many countries, governmental bodies account for around 50% of all goods and services purchased within the country. The methods used in buying by governments and other institutions are therefore very important.

The key elements of buying by governmental institutions are as follows.

(a) Buying will be a bureaucratic process

A bureaucratic process is more likely to apply than an open DMU approach – or, at least, the DMU roles are likely to be submerged within the bureaucratic framework.

(b) A tender system is usually used

The tender system is used by governmental bodies to ensure public accountability. The taxpayers' money needs to be spent, and to be seen to be spent, efficiently and without corruption. The tender system aims to reduce or eliminate personal bias and prejudice in the awarding of what are often very large contracts. (In practice, of course, bias of various kinds might exist.)

The broad principles of the tender system are the public announcement of a contract for specific goods or services inviting those wishing to respond do so by submitting a quotation for the contract – a tender. Details of the contract and the criteria for selection are made available to interested parties. All tenders remain sealed until the buying committee meets and they are all then adjudicated according to agreed rules.

There are two main tender systems, open tender and selective tender

- an open tender system is one where anyone can submit a tender;
- a selective tender system is one in which only specified contractors are invited to submit a tender. There will usually be lists of appropriate companies for different types of contract and companies will be concerned to develop and maintain relationships with the buying organisation to get onto those lists.

The adjudication of tenders might be based on the lowest price tendered or it might be based on an estimation of best value, in which case factors such as quality and delivery may be important.

(c) Political influence

The decisions of governmental bodies are ultimately the responsibility of politicians and buying decisions – particularly those involving the award of large contracts – may have political importance. Thus, there is always the possibility that political influence will be brought to bear to achieve a satisfactory outcome.

The type of political system will also influence government purchasing. The more democratic systems of the US and EU countries will buy differently from central controlled and command approaches, such as those in Cuba, China and, in the past, the COMECON countries – the USSR, Poland, Bulgaria, etc.

(d) National preference

In most countries, for all the obvious reasons (political, economic, employment, etc.) governmental institutions will try to buy from their own nations. In some countries, national preference will be a major barrier to market entry for companies seeking to export.

In the EU a high priority has been placed on reducing the barriers created by national and regional preference. Legislation has been enacted to provide free and fair competition in the area the EU calls "public procurement" (i.e. government and institutional buying). Public contracts must be predetermined in one of two ways – lowest prices or best value. Whichever tender is best, according to the method selected, will win the contract. Public procurement contracts showing preference to national suppliers will be penalised. This has implications for the market opportunities of EU companies specialising in gaining government contracts.

(e) Types of business and government buying

Certain types of business are more dependent upon government buying than others. Most goods and services can be bought by government and institutions, but some markets revolve solely around government decisions. A good example of this is companies selling defence equipment – tanks, guns, radar, night sights, etc. National governments are, generally, the only buyer of defence equipment within a country, and they may also control which other countries may be supplied – for example, the ban on arms supplies to Iraq or the controls that the US placed on arms and defence-capability-related equipment to the COMECON countries.

Once again, it is important to stress that business must carefully look for differences in institutional or government buyer behaviour in international markets. Once more, cultural factors will play a key role in giving rise to differences here, but so too, given the nature of the buyer, will political differences. The business must therefore carefully analyse and appraise each market in which they operate or intend to operate, developing an in-depth understanding of customers and customer behaviour in each market. Then, and only then, will it be in a position to make a decision about the extent to which there are similarities in customer behaviour.

D. BUYING BEHAVIOUR IN LESSER-DEVELOPED COUNTRIES

We identified that these countries are poor with comparatively low levels of economic and social infrastructure. It is difficult to market to these countries because there is little spending power and market sizes are small in most instances.

The usual support systems are often deficient in some ways, for example, the electricity supply might be unreliable. Amongst other things, this would reduce the market for consumer durable products that use electricity as a power source. The physical distribution of products can be difficult because of poor quality road or rail systems – products can take longer to arrive because speeds on the road or rail systems are much slower than in more developed countries and may even be damaged by constant bumping and jolting. Companies may also suffer cash flow problems because of time delays between product delivery and invoice payment.

This does not mean to say that these markets should necessarily be ignored. In most LDCs it will be possible to sell some products. In particular, companies might be willing to accept low sales because they hope to become well established and be in a position to benefit when the country begins to grow and develop larger, more worthwhile markets. Companies might also wish to prevent their competitors picking off easy, unopposed market opportunities. Note that, in some LDCs, the size of the total population may result in worthwhile sales – for example, Nigeria with a population of around 110 million – even though the sales measured on a per capita basis might be low.

Consumer Buyers

Most consumers will have very low levels of income and little discretionary spending power. Consumer buying decisions will, therefore, be considered more carefully because, relatively, the cost of purchase will be very high.

Think, for example, of the different significance for a consumer in an African country with a family annual income of £500 considering whether to buy a portable radio priced at £15, compared with a consumer in Germany with a family income of £20,000 considering the same purchase. For the African family the purchase is very significant, it involves considerable risk. For the German family the expenditure is so insignificant in terms of the total spending power that it could be almost an impulse purchase.

There will, though, be some segments of the population with higher amounts of money to spend, including an urban middle and upper social class as well as some expatriate managers, administrators and civil servants from other more affluent countries. There will be a ready market among these groups for fast moving consumer goods (FMCGs) which can be sold with little or know adaptations.

For the less well-off citizens of an LDC, fast moving consumer goods might have to be adapted in the following ways:

- The product size might be reduced in order to reduce the price. Razor blades might be sold singly instead of in a pack containing 10 or 20 blades. Food products might be sold in small pack sizes rather than the US large family pack.
- Product labelling might need to take account not only of different languages, but also the level of literacy. If low levels of literacy are encountered, it might be necessary to use colours and symbols to aid identification rather than to rely on written words.
- Advertising might take visual and aural forms rather than press advertising.
- Sales promotions might be limited because of the inability of retailers and wholesalers to handle the promotions.

Business Buyers

There will be comparatively few business buyers. It is likely that industrial development will be limited to a few industries, probably based upon developments from the primary production of agriculture, fishing or the extraction of minerals – for example, the canning of vegetables or the mining of coal. LDCs often rely heavily on a few products for their total export earnings. As a result, they are usually limited in their reserves of convertible currencies. This means that the political and economic management of LDCs is often geared to encouraging exports from their country and discouraging imports into it.

Distribution channel intermediaries – retailers, wholesalers and distributors – represent another type of business buyer. Many of these intermediaries operate on a very small scale with limited capital

resources. It is difficult, therefore, to sell large quantities of product without resorting to a wide-scale coverage of wholesale and retail outlets.

If there are marked differences in the cultural context level, there will be considerable difficulties in understanding and developing strong working relationships with business buyers in LDCs.

Government Buyers

In many LDCs, the influence of the government and government-influenced buying departments is high. For major capital projects – for example irrigation systems or hydro-electricity schemes – the domestic government, together with foreign country and major world agencies, will be important participants in the buying and the financial funding processes.

It is often the case that the bureaucratic processes of government bodies in LDCs will slow the whole decision-making process by requiring a series of permits, approvals and agreements before projects can proceed. In some countries, the bureaucracy relies on a certain "oiling" in order to gain approvals. Cultural differences between what is regarded as an acceptable exchange of money for a service and what is a bribe vary from one culture and one country to another. It is certain that in some countries it is important to know the right people and to understand and use the right system of inducements to ensure that the contract is agreed at the right level in the government.

E. BUYING BEHAVIOUR IN NEWLY INDUSTRIALISED COUNTRIES

The main attraction of NICs is the growth potential that they represent. Some NICs, particularly some countries in S.E. Asia (such as Malaysia, Korea, Singapore and Taiwan) have consistently shown faster than average growth for a number of years. This higher level of growth, when contrasted with slow growth or recession in many other parts of the world, together with their higher levels of income per person in the population, makes NICs particularly attractive as market opportunities both for consumer goods and business supply.

Note, though, that whilst there are considerable opportunities in these markets, there are often barriers to entry into them. The governments of NICs sometimes set high tariff barriers on goods coming into the country in order to protect their own developing industries.

Consumer Buyers

The consumer markets in NICs can develop rapidly once a certain critical point of income level has been reached. In consumer durables, the growth possibilities of opening up the market in NICs are very attractive, particularly where the markets in more developed economies have reached the maturity phase of the product life-cycle. Increasing affluence also allows the development of FMCG markets which initially might have been slow to grow because of income constraints and conflicts with indigenous culture.

Retailers are changing their approaches from small, customer-service market stalls and small fixed units into some of the larger, more capital-intensive styles of Western retailing. These changes provide opportunities for retailers from other countries to enter the NIC market.

Many of the NICs are in Asia and Latin America. For international businesses operating from Europe or the US, this poses problems. The cultural differences between the comparatively low context Europeans and North Americans and the high context Asians and Latin Americans are quite large. There are, of course, examples of countries with smaller context gaps – for example, Spanish

companies will have far fewer cultural difficulties in marketing to Latin America than would a British or Scandinavian company.

Business Buyers

The growth in NICs has been created through the expansion of business. Accordingly there are many more business buyers than in LDC countries. As the NICs expand, there is an inevitable link to increased demand for a wide range of infrastructure improvements – power and communications, education and health care, in addition to internal and external defence.

The increased opportunities to market to businesses have to be set in the context of the cultural differences of many of the NICs. This may mean that understanding the ways in which business buys is more difficult than in low context culture countries. Whilst the main concepts of business buying hold true, the nature of the roles in the DMU, or the length of time taken to go through the whole process, might be rather different from more advanced industrial companies.

It is also quite likely that the nature of competition in NICs will be fierce. Local suppliers will have advantages of lower labour costs and less transport and packing expenses. The NIC competitor might also be prepared to operate on lower profit margins than companies from the UK and the US. Business buyers in NICs might favour local suppliers in any event, but be particularly attracted to them because of the lower prices offered by the local, indigenous supplier. To succeed, companies from more highly industrialised countries will need to offer more sophisticated, high technology solutions. If they are able to do this, and keep in front of their NIC competitors, they will maintain their market position in NIC countries.

Government Buyers

Government buyers in NICs will be a major source of business. The need to maintain control of inflation, government spending and the balance of payments during the turbulent times of fast growth will encourage overt or covert support for local businesses.

F. BUYING BEHAVIOUR IN HIGHLY INDUSTRIALISED COUNTRIES

Most of the material written about marketing has come from the US and from Europe. More recently, material has started to appear from Japan. All the main concepts of buyer behaviour have originated from scholars in highly industrialised countries. Because of this there is a cultural sympathy between the concepts and the culture of buyers in these countries. The main exception to this is Japan. In many ways Japan is different. It is a high context culture. It has been isolated from many cultural forces until quite recently and has evolved a number of different business and management systems. For example, just-in-time and an insistence on quality both originated in Japan.

In considering marketing to highly industrialised countries, it is perhaps more useful to think about the problems facing an LDC or an NIC producer in attempting to market products in the US, the UK or Germany. That is not to say that marketing from one highly industrialised country to another is easy, but the level of difference (Japan excluded) is not so large as in the former situation.

Consumer Buyers

A major problem will be overcoming the country of origin problem, especially in the purchase of consumer durables. To overcome this problem, the NIC or LDC company might need to sell products at a low price and include many additional features within that low price. In addition, they will need

to fight hard to secure adequate distribution channels. After-sales service will need to be convincingly strong to reassure potential buyers.

The main markets for LDCs are in craft products and ethnic fashion clothing, as well as certain food products – for example, bananas from Caribbean countries.

Business Buyers

The difficulties are somewhat lower amongst business buyers. It is likely that business buyers will be more receptive than consumer or government buyers since they will judge products on more objective and careful evaluative criteria.

Businesses around the world are trying to find ways to cut costs. They are, therefore, receptive to business propositions that offer reliable, high quality production at lower prices than can be obtained from suppliers based in more highly industrialised countries. The opportunity that LDC and NIC suppliers have is the lower costs of land and labour. The difficulties that they face are those of convincing the business buyer that high quality product will be supplied consistently with reliable delivery.

Government Buyers

There are opportunities to sell to government buyers, but in practice it will be difficult for LDC and NIC suppliers to gain contracts. Geographical distance and political pressure, plus the sophisticated manufacturing and marketing expertise of the local suppliers, will offer few gaps in the market. There is usually quite strong pressure exerted by business and through political considerations to buy from local suppliers – local suppliers provide local employment and politicians can gain support from the electorate by promoting their interests.

Study Unit 6

International Marketing Research and Analysis

Contents ***Page***

(Continued over)

INTRODUCTION

In this study unit we shall examine the important area of international marketing research. If companies are to follow the marketing concept, they have to understand the customer. Marketing research is an important way to help understand the buying process. It can help unravel the ways in which the marketing mix can be reformulated to improve demand.

Although there are lots of specific uses of marketing research in international business, the main uses are in the identification of marketing opportunities and the exploration of similarities and differences in international markets.

We start by looking at the importance of defining the research problem. Because of the wide range of problems in the international area, it is particularly important to define problems before spending further resources. We then move on to consider secondary and primary research and data. Secondary data is a significant way to cut costs and to save time when researching international markets. In advanced countries there is usually much information, and the problem is how to use the data. In less developed countries the lack of data is likely to be a bigger problem. Primary data will be collected when marketing problems have significant costs attached to them. The specific information provided by the research needs to be carefully constructed. Errors caused by the faulty translation of questionnaires, or by using inappropriate cultural approaches, can appear all too easily in the rush to complete a research programme on schedule.

The organisation of international research is an important decision area. A clear definition of the problem to be solved is vital. The larger the number of countries being researched, the greater the problems of achieving comparable data. In this situation the selection of suitable research agencies and the co-ordination mechanisms will be important. The co-ordination and management process has cost implications. The company either has to manage the process in-house or pay marketing research agencies to handle this for them.

Our final area of study in respect of research activities themselves is recent developments in international marketing research. We highlight the growing use of collaborative and consortia-based research, the growth of databases, the increasing use of the internet for research purposes and finally the growth of expert/intelligent systems which can provide real time information for decision-making.

(To understand international marketing research, you need to have an understanding of marketing research as it operates in domestic markets. If have not studied marketing research in much depth before, you will need to do some extra work on this area.)

In the last two sections we turn to a consideration of how information should be analysed in assessing market opportunities. Unlike domestic business, in the international context there are many markets and many environments, and it is impossible to carry out in-depth research on all of them. Most companies, then, find it helpful to use a comparative approach which, by comparing factors such as size, trends and profitability of different country markets, one with another, allow judgments to be made about alternative markets. We will look at the need for comparative approaches in targeting opportunities and explore a number of different approaches which may be adopted. Finally, we consider the need to assess markets in their own right as distinct from their characteristics in comparison with others.

A. DEFINING THE RESEARCH PROBLEM

In any marketing research the crucial first stage is to define the problem that the company is trying to solve. It is always easy to collect interesting information – however, when considering research requirements, remember "need to know, not nice to know". It is much more difficult to collect that information which will help reduce the amount of uncertainty and ignorance connected with business and marketing decisions. If the problem is incorrectly defined at the beginning, little help will be provided at the decision-making stage.

Let us take the example of a company suffering a 25% sales decline in Italy. What is the problem that marketing research is helping to solve? Is the 25% decline the suitable definition of the problem? No. We need to find out the reasons for the decline. Once we know some of the basic reasons, we can use marketing research to give us a better understanding of our real problems. Some of the reasons for the decline might be:

- A general reduction in the Italian market
- Increased competition from Italian or other companies
- Less sales support from the distribution channel members
- The advertising campaign is not understood by Italian consumers, etc.

Defining the research problem is particularly difficult in international markets because of the number of markets that have to be covered and, as we discussed in Study Units 1 and 2, with current trends in international trade it is often the case that the market spans more than one country, making the comparability of data very important. It is also more difficult because we normally have less knowledge about the non-domestic country markets. We have further problems because of cultural differences between researchers in company headquarters and prospective buyers in different international markets.

Obviously the range of specific research problems which international marketing research is used to address, is potentially enormous. Examples of research problems on which international marketing research might focus include the following:

- Assessing market size and potential
- Exploring similarities and differences with a view to country selection
- Marketing mix research to determine product, price, promotion and distribution elements
- Competitor analysis
- Identifying modes of market entry
- Selection of suitable intermediaries

Overall, however, although we have stressed the importance of defining the specific research problem, more than anything else, marketing research in international markets is underpinned with identifying marketing opportunities. In addition, because, as we have seen, the distinguishing feature of international marketing is that it is carried on across international frontiers, we often find that international marketing research is concerned to identify similarities and differences between international markets. We shall return to this aspect of similarities and differences again in later study units, such as Study Unit 7 which looks at the use of comparative analysis in international market appraisal. We shall also come across the importance of analysing the similarities and differences when we consider the issue of standardisation versus adaptation in the international marketing mix.

Sources of Information

A variety of sources can be used to help obtain information to provide the context of the problem that the marketing research will assist. These sources would include:

- Talking to marketing decision-makers and other managers, especially in the countries concerned.
- Reading professional journals and newspapers, again particularly from the country concerned.
- Locating and reviewing existing marketing research information from surveys and data sources.
- Talking to suppliers in the countries concerned.
- Visiting major trade fairs and exhibitions. These can be a very useful source of background information. However, most major trade fairs are held only once a year or once every two years. Therefore, the timing of the trade fair might be incompatible with the marketing research time schedule.

Developing a Marketing Research Brief

It is useful to formalise the process of defining the problem and, once the processes of initial thought, discussion and information search have been applied, it is helpful to prepare a research brief.

A marketing research brief is a formal written document that specifies the key requirements and background context of the defined research problem. The process of writing the brief often clarifies issues, prevents misunderstandings and gives an opportunity to review and enhance the original views. It can then form the basis for briefing not only the researchers themselves, but also management to ensure that everyone involved is clear about the objectives and requirements. This provides a further opportunity to improve the quality of the research process as well as a control to evaluate subsequent proposals.

The brief should cover the following:

- A definition of the marketing research problem.
- The objectives of the research.
- The information that needs to be collected.
- The benefits of collecting the information and the potential costs in making the decision without the research.
- The time plan for the research – this is often a critical factor and one that will influence the research methods used, the reliability of the information and the cost of the research.
- An estimate of the research costs.

The Research Plan

The marketing research brief is an important step in the research process, but to manage the process a detailed marketing research plan needs to be developed.

This will take the general elements of the brief and specify the way in which research will be conducted in order to meet the objectives. Thus it will specify the research methods to be employed, with particular reference to the use of secondary research sources and methods of collecting primary data.

It may also further develop aspects of the original brief to make them more specific and practical in respect of the data collection. For example, if the company is interested in European markets, there

are questions about the geographical scope implied – which definition of Europe is to be used, is it specific to the EU or does it include EFTA, are Central European countries such as Poland and Hungary included, what about Turkey, etc.

B. SECONDARY DATA

Kotler defines secondary data as the "information that already exists somewhere, having been collected for another purpose". Secondary data forms the basis of comparative analysis and is generally used first in the research process, before moving on to the more expensive process of collecting primary data.

Start with Available Information

Why is it important to use information that is available to start the marketing research process? There are two obvious main reasons – money and time

(a) Cost

Most forms of secondary data are quite cheap to acquire and use. The reason for this relates to the definition of secondary data. Because the data already exists, the costs of developing the data have already been paid. In some instances, secondary data might be free – for example, the statistical year book published by the United Nations, or the reviews of countries in the world by the World Bank. In other cases, data has to be bought at market prices. Usually, however, the market rate is influenced by the number of potential buyers. Thus, the price is often much lower than the costs for collecting all the data. The initiators of the data cover their costs (and make contributions to profits) by selling to many buyers.

Note that using secondary data is not free. Even if you have access to the data at no cost, the organisation still needs to pay the people cost of looking for, understanding and analysing the information. The important point to understand is that secondary data is a ***lower cost*** source of data than primary data. All organisations are anxious to be efficient, not to waste money. Because of the vast range of information needs in international marketing, secondary data sources are particularly important.

(b) Time

The second main reason for using secondary data is to save time. Time is important. Companies can save time by paying higher prices for faster methods, but secondary data sources are usually the best and first way to save time in marketing research. Time is saved because the information already exists. The time taken is thus restricted to the time needed to find the data.

Sources of Secondary Data

One of the important skills in international marketing research is knowing where to find appropriate information.

(a) Types of source

There are four main sources of secondary data:

(i) Internal sources

Internal sources include company sales figures, financial information, reports from sales visits, reports from agents and distributors, and previously obtained marketing research reports.

The value of internal sources depends on the nature of the problem. For example, if the starting point is a 25% sales decline in Italy, internal sources can be used to pinpoint which customers, which part of the distribution channel, which parts of Italy and which products or services are causing the decline. You still do not know ***why*** the decline has happened, but you do know where to direct your research activity.

Companies that are new to international marketing or have no experience in the markets in question will have few useful internal data sources. On the other hand, long established companies, for example Unilever in African countries, will have access to considerable amounts of relevant data.

(ii) Government publications

Most industrially advanced countries will have large amounts of published data. On the other hand, less well developed countries usually have fewer publications and less reliable data contained within them.

(iii) Other publications

There are a variety of organisations that produce useful publications. In some instances the results of original research data are published, whilst in others the publications are compilations of data available from other sources (such as government publications). Organisations like banks, trade associations, chambers of commerce and export associations are useful sources of secondary data. Data availability might be restricted to members, or members can buy publications at lower prices than non-members.

(iv) Commercial data

This type of data is different from (iii) because the data is developed for business motives. Commercial data is usually produced by marketing research companies and sold at prices judged to be the market price. A. C. Nielsen is a marketing research company operating retail audit panels in many countries. The data is available to those companies wishing to pay the price.

It is more usual for such commercial data to be available for consumer goods markets than for business-to-business markets.

(b) Location of sources

The normal place to look for secondary data from government and other publications is a library. In the UK the best library sources for international marketing are to be found in university and college libraries and in the DTI library in London.

The increasing importance of on-line data bases, microfilm, CDs and the Internet should be noted. These are valuable ways to locate information quickly.

Problems and Quality of Secondary Data

There are a number of problems associated with attempts to use secondary data in international marketing:

- ***Lack of data*** – In some markets there might be little or no secondary data. This is most likely to happen in business-to-business markets, and generally in less developed countries. Data for cars or alcohol might be widely available, but very limited for electrical connectors and adaptors.
- ***Accuracy*** – Different statistical methods may have been used and with varying degrees of efficiency. The result is considerable variation in the reliability of secondary data produced in different countries.
- ***Age*** – Data will have been collected at different times and with different time spans between the collection of data.
- ***Comparability*** – This is a major difficulty in international marketing and one which is of increasing importance as companies seek clusters of countries in which to trade and adopt pan-regional marketing mixes.

In order to test the quality of secondary data, it is useful to ask the following questions:

- ***When was the data collected?*** It is important to establish the age of the data. Often you have to go back several years to find returns from the countries you wish to investigate – for example, in the year 2000, it is probable that 1997 or 1998 will be the latest year for which figures for international comparison are available. In some markets, major changes will happen within a year – the recent growth in the use of the Internet both commercially and in the home is just one example.
- ***What methods were used to collect the data?*** You will need to be experienced in marketing research to appreciate fully the different results likely from different methods. However, you should notice the variation in methods used and assess its likely impact.
- ***Who collected the data and why?*** The purpose of collecting data and the particulars of the agency responsible may be significant. For example, a government anxious to show that inflation is decreasing might collect data in ways that minimise price increases. In looking at the international picture for inflation, distortions might then happen because of differences in the quality of secondary data.

C. PRIMARY DATA

Primary data is referred to by Kotler as consisting "of original information for the specific purpose at hand". Thus, it may be information obtained from conducting product tests or advertising recall studies – in fact anything conducted for the specific purpose.

Primary data is more costly and takes longer than using secondary data, especially in the international context where there are particular problems. Its use, therefore, should be limited to those areas shown to be necessary after defining the research problem and after using secondary data.

A Review of Methods

You will probably be familiar with the main aspects of conducting primary research, so we shall just briefly review the key elements here.

(a) Types of research

There are two forms of primary research:

- ***Qualitative research*** – this is research designed to answer the "why?" question. It seeks to explore attitudes and impressions, and is often carried out through focus groups (sometimes called discussion groups) or in one-to-one in-depth interviews.
- ***Quantitative research*** – this, as the name implies, seeks to count the number of respondents with particular attributes. Typical example s include “how many people own bicycles?”, “how many people use their bicycle to travel to work?”, etc.

(b) Sampling methods

Decisions have to be made about whether to use probability or non-probability-based samples.

Probability-based samples require accuracy of information to ensure that each nth item selected in the sample has an equal chance of selection. This level of accuracy might not exist in all countries.

Non-probability-based samples can be:

- Convenience samples;
- Judgment samples; or
- Quota samples.

(c) Data collection

The three main methods of contacting people and collecting information from them are by post, telephone and personal contact. Each of these has its advantages and disadvantages from an international perspective, for example.

- In respect of the post and telephone, the infrastructure, quality of the service and availability varies. In general, the LDCs will have poorer and less reliable services. Taking the telephone as an example, 94% of homes have a telephone in France, whereas only 26% do in Turkey. Would this make a difference to the decision to use a telephone survey? The answer depends on the defined population – if the population is within the 26% of homes who have a telephone, this is fine, but if a mass-market type of population is required, the telephone would be very restrictive (i.e. biased) if used as the basis of research in Turkey.
- In respect of using the post, the literacy levels of the population would be a factor. A further factor may be that, in high context cultures where information is often communicated by non-verbal means, postal surveys may not capture the information sought.
- In respect of personal contact, cultural factors may have a significant bearing. For example, in Arab countries, contact with women members of society is strongly disapproved of in many circumstances. In other countries, those seeking personal information (of any kind) may be viewed very suspiciously – both by those from whom the information is sought (interviewers may be seen as spies) and by government bodies who may distrust the role of interviewers.

The most appropriate method of data collection will have to balance the same factors that are relevant in the domestic market – response rates, type of information that needs to be collected, the speed of response required, and cost factors (personal interviewing is a much more expensive method than post or telephone) – and assess them in respect of the international context. The final method selected will have to be decided on grounds of efficiency and MR reliability. Local knowledge of the country will be important in making the decision.

(d) Questionnaires

As you know, it is difficult to write a high quality questionnaire in your own language. It is even more difficult when it has to be co-ordinated across several languages.

The basic principles of questionnaire design are:

- Ask one question at a time.
- Avoid ambiguity.
- Avoid leading questions.
- Treat personal and potentially embarrassing questions with great care.
- Always test (sometimes called a pilot test) a questionnaire before it is sent out to interviewers. The testing process might need to be repeated several times before the questionnaire is right.

In international research the questionnaire should be translated with great care to avoid errors. A way to do this is to use the ***back-translation method***.

- The questionnaire is translated from the original into the other language by a bilingual who is a native speaker of that other language.
- The translated questionnaire is then translated back to the original language by a bilingual who is a native speaker of the language used in the original questionnaire.

In this way differences can be found, isolated and then resolved.

Cultural Issues

Culture issues will affect many parts of the marketing research process. It will influence the definition of the research problem (because culture is one of the factors influencing the buying process – it affects needs/wants; beliefs; perception; information search processes and evaluation, etc.). It will also affect the data collection method, questionnaire design and how questions are answered. For example, in some cultures, it is impolite to be rude or critical about other people. The person being interviewed, the respondent, may give more favourable answers than is, in fact, his/her real opinion. Languages, and translation into different languages, result in certain inaccuracies in capturing the exact meaning as intended by the respondent.

D. MANAGING THE RESEARCH

There are two main alternatives methods of managing a marketing research project – doing it in-house or using a marketing research agency.

In-House

As we have seen, a considerable emphasis in international marketing research will be placed on defining the problem accurately and on using secondary data. A company's own resources might well

be used for secondary data collection and analysis, but it is much less likely for primary data collection (lack of specialist skills, infrequency of use of specialist techniques, etc.).

In respect of problem definition and initial evaluation of a market, it may be that the company itself may participate in trade fairs and fact finding missions. Both these methods enable the company to build up its own knowledge and understanding of the market:

- Trade fairs give easy access to competitors' products, literature, corporate identity and standing, and the quality of their people. They also provide access to others interested in your product market – i.e. buyers.
- Fact-finding missions, if carefully selected and adequate preparations are made, provide valuable first-hand contact with the people, potential buyers, potential distributors and the environment of the country. There is, of course, the need to get out and about – living life solely from the airport, taxi and international hotel can give very misleading impressions.

Using Specialist Research Agencies

There are several different types of research company arrangement, and these are expanding with the tendency for companies to decrease the size of in-house marketing research services departments.

(a) Select research companies in each country to be researched

The selection of research companies based in the country you wish to study gives certain benefits:

- Expertise in the local environment
- Expertise in the local language(s)
- Expertise in the local cultures.

There are, however, certain difficulties:

- How do you select a good quality agency?
- How do you co-ordinate local agencies?
- How do you manage the language and culture interface between your company and the marketing research agency?
- How do you establish the "right" price to pay for the research?
- How do you ensure comparability of the data between the different agencies?

(b) Select a marketing research agency that specialises in the industry in question

Such an agency might well have expertise in carrying out research in different countries around the world. This approach will reduce some of the difficulties shown above, but may create other problems, particularly if there is no specific experience in respect of the language and culture of the market in question.

(c) Select a global marketing research agency or an agency with a well established network of co-operating agencies.

This approach could be attractive for the client company with global scope to its operations.

Marketing research companies have been developing their global capabilities in response to the strategic developments in the buyers of marketing research services. In particular, we have seen the emergence of demands for branding studies, long-term tracking performance studies, and for research to spread beyond the boundaries of the FMCG companies.

Whichever method is selected, the company concerned will need to demonstrate competence in the appropriate survey method (for example, group discussions), to have knowledge of the product market in question, and to have competence to operate in the appropriate country or countries. Knowledge of the appropriate culture, language and operational competence in the country are very important. The price quoted by different companies will be another important factor.

F. DEVELOPMENTS AND TRENDS IN INTERNATIONAL MARKETING RESEARCH

Perhaps not surprisingly, in such a dynamic area as international business, techniques and approaches to international marketing research are themselves dynamic and changing. Some of the more important developments and trends in international marketing research are outlined below.

The Growth of Multi-Client/Consortium Approaches

Marketing research can be expensive, especially where the marketer starts from a zero knowledge base about the particular market. Increasingly, companies operating in and needing to research international markets are looking towards the use of multi-client and/or consortium approaches to conducting, and therefore paying for, marketing research. The technique of omnibus surveys, therefore, is used widely now in international marketing research. In addition, some companies now carry out their own marketing research in conjunction with other companies in order to share the costs.

The Growth of International, On-Line and CD Rom Databases

Database marketing has grown in all areas of marketing activity, but has proved to be particularly useful for conducting marketing research in international markets. In fact, there are many companies which specialise in providing cost-effective, quick, and accurate databases for companies wishing to research international markets. Examples include:

- Reuters
- European Kompass
- Extel
- Business International
- Euromonitor

The Internet

Once again, developments in this area have already begun to revolutionise marketing research and information gathering in international marketing. The Internet has proved particularly useful for the collection of competitor intelligence, market appraisal and screening, intermediary selection and in the search for similar segments across geographically dispersed regions and countries.

This last point is particularly important. The following characteristics of the Internet are particularly relevant to identifying globally similar segments:

- The interactive nature of the Net enables two-way communication with customers visiting a company's website.
- Integration of website responses allows the building of customer profiles provided the right information is asked for.

- Used together with other customer data sources, segment data can be constructed.
- This allows a company to develop a website strategy which can be clearly targeted at the identified similar customer segments.

In this way, the Internet can be used to simplify the market research process with the following advantages:

- It is very cost-effective compared to, for example, using interviewers and other more conventional research tools
- It helps to eliminate research bias as respondents are self-selecting.
- Strategy responses to research information can be planned much more rapidly.
- Some of the cultural, language and other problems of conducting marketing research across national boundaries are removed.

Companies which have already built successful Internet businesses based – for example, Amazon – have been quick to spot the potential for building and using databases and information which the Net offers.

Needless to say there can be problems with using the Internet. In particular, systems need to be secure if they are not to be subject to "piracy" by competitors.

The Establishment and Use of International Marketing Information Systems

Although databases are important, data only becomes useful where it provides information for decision-making. Companies and marketing researchers have moved away from thinking about simply the provision of data or even information towards the establishment of ***Marketing Information Systems***.

The main function of a marketing information system is to provide managers with the information they need in an appropriate form and at the appropriate time. A marketing information system for international marketing is in essence no different to that which would be used for purely domestic marketing, other than of course that it encompasses a wider spectrum of information sources and needs. The international marketing information system should include systems for collecting both primary and secondary data, the analysis of this data and a marketing decision support system which translates the data into information for decision-making. Once again, access to cost-effective computer memory has facilitated the growth of international marketing information systems.

Intelligent and Expert Systems/On-Line Real Time Systems

The most recent development in marketing information systems has been the growth of systems which allow the marketer to receive and interpret marketing information almost instantaneously. Again, developments in computing and information technology have helped facilitate this. Decisions can be made virtually in real time which, of course, gives the marketer a major advantage compared to slower competitors. In fact, there is evidence to suggest that speed of access to, and use of, information is becoming one of the most important sources of competitive advantage in international markets.

Although we need not concern ourselves with the technicalities of such systems, some of the main characteristics of an effective intelligence based on-line/real time are as follows:

- Limited but relevant data on key marketing areas such as customers, products, regions, etc.
- An electronic data gathering system.

- An operating system, including a central database.
- Effective implementation procedures including clear delineation of authority and responsibility for decision-making on the basis of the information.

Needless to say, such systems will still need to be carefully designed to meet the decision-making needs of the marketer. Amongst some of the major potential problems are the following:

- The systems may be too technical and complex for effective use by the marketing manager.
- Decision-making support systems such as the necessary authority to managers may not allow the information to be acted upon quickly enough.
- Unless properly designed with decision-makers in mind these systems can become subject to "information overload".
- There is a danger of these systems being "hijacked" by the computer and information systems experts such that they become "technical marvels" rather than systems for helping improve marketing decision-making.

G. COMPARATIVE ANALYSIS

The analysis of a market will usually want to focus on the market size for the product or service in question. Companies need, in addition, to have an appreciation of the context in which the market operates. One figure giving a market size is rather like a snapshot of a sporting event. The picture might be good or bad, but you do not know what went on before, nor have you any real evidence to predict what might happen in the future.

Obviously, with an infinitely large marketing research budget, it would be possible to carry out specific surveys to measure the responsiveness of buyers to a product in every country market. This, though, would be prohibitively expensive for even the largest companies and, thus, very unlikely. Companies usually use available information to identify the main opportunities, and only when the general opportunity is established will more specific research be used.

The most useful approaches to comparative analysis are those that provide the broad background to a country, allowing these general opportunites to be identified. A further consideration is that general statistics on population size and certain economic indicators are usually widely available, whereas information on particular market sizes often needs to be specifically collected or calculated.

A major reason for, and use of, the SLEPT and C analysis referred to in Study Unit 4 is to compare and contrast different countries with respect to their similarities and differences. So, for example, a comparative analysis might include social/cultural factors, legal, economic, political and technological factors plus an analysis of currency and competitor factors. We outline some of the key areas for comparative analysis in detail below, but first we should further examine the role of this form of analysis.

The Objectives of Comparative Analysis

Let us take as a starting point a UK company that specialises in making wooden doors and window frames, selling these to builders and civil engineers. If the company decides that it wants to export (perhaps because the UK building market is depressed), it has a major decision to make about which country or countries it should target. If we further assume that this company has received good marketing advice about collecting relevant information before making a decision, we have to ask the question, "What sort of information should be collected?"

The relevant information will consist of data about various countries and much more specific information about the market for wooden doors in each country. In some markets there might be good quality information about wooden products, in others there might be little or no information.

Initially, the company will want to assess the information received, but will have little experience about how to manage the process. The company will, almost certainly, compare the information from various countries with the market it knows best – its domestic market (for example the UK). Is the market bigger or smaller? Who are the competitors? What are their strengths and weaknesses? Is the competitive situation more or less difficult than in the UK? What prices can we obtain? Is this better or worse than the UK? Can we sell the same products or do we need to make changes?

You could probably add many other comparative considerations. The essential point is, though, once the company has collected information from a number of countries, it is able to compare and contrast one country with another.

Although the scale of the comparative analysis will vary, it is an approach that is relevant to the different types of international business, for example:

- Smaller companies are most likely to use comparative analysis to assess market opportunities – to decide which countries they should enter and which countries should receive priority. It is, therefore, the first stage in screening countries so that, at low cost and quite quickly, a company can discard less attractive countries and concentrate resources on examining the remaining, more attractive countries more closely.
- Larger companies are more likely to use comparative analysis as part of their international marketing information system. In addition, by collecting information and then comparing it, country by country, a more sophisticated approach to international business planning can be undertaken. Companies can tailor their strategic decisions to the conditions applying in the various countries with which they currently trade and may operate in – for example, based on predictions of different growth rates or other economic problems or opportunities. Thus a company might switch investment away from one country to another, or place more reliance on agents and distributors than on its own resources, where there is a risk of restrictions being placed on the transfer of capital and foreign currency.

Note that it would be dangerous to rely on comparative analysis as the only method to determine marketing opportunity. Comparative statistics are rarely totally reliable for example, in underdeveloped countries, a lack of infrastructure can make the collection of accurate data very difficult, and in the former Communist countries available data may have been put together to support propaganda rather than to give an accurate picture. Further, market opportunities are specific to an organisation. The fact that the largest country market is in the United States, whereas the wealthiest people – as measured by GNP per capita – are in Switzerland, would be be irrelevant to a company specialising in diamond mining equipment. Here, market opportunities will be based in the diamond mining countries such as South Africa, Namibia and Angola, and there will remain a need to assess specific markets.

The General Level of Economic Development

There are a number of idicators which can be used to compare the stage of development in different countries.

(a) Types of economic activity

Countries develop income from one of three types of economic activity:

- ***Primary*** – these activities are to do with agriculture and extractive processes, for example coal or diamond mining and fishing.
- ***Secondary*** – these are manufacturing activities. A common early form of manufacturing is food processing – for example, canning vegetables, fish and meat products. Manufacturing moves through a wide range of low value-added activities, for example assembling pre-manufactured components, to very high value-added activities in the biochemical industries.
- ***Tertiary*** – these are activities based on the provision of services. Insurance, tourism and education would be good examples of services.

In general, the more developed the country, the more likely it is to have an increasingly significant part of its income derived from the service sector. One way, therefore, to look at different countries might be to classify them by the percentage of national income that results from service activities. We would expect to find the more industrially advanced countries at the top of the table and the less developed countries toward the bottom.

You should note, though, that all countries will usually have income derived from each of the primary, secondary and tertiary sectors. Whilst we have identified that service industries are a feature of advanced economies, this does not mean that primary industries have no importance to countries like the US and France. The blockades of Channel ports by French farmers in the row with other EU countries over the import of livestock are a good reminder that even countries at the heart of the EU still rely on income from primary economic activity.

The standard analysis is that the less developed countries are heavily dependent on primary industries. This dependence is often accentuated because the country produces a narrow range of products. For example, some countries in the Caribbean specialise in the production of bananas, others might produce coffee or tobacco, while yet others rely heavily on coal and other minerals. These countries are very reliant on the world price for their products. When the world business cycle is depressed, the demand for primary products goes down, but the supply of these products, particularly agricultural products, is less easy to manage. The usual result is that prices go down, often considerably. It may be seen, therefore, that the ability of LDCs to pay for imported goods varies with the fluctuations of the business cycle and related prices.

(b) Other factors

It is worth noting that there are relationships between economic development and the following factors which may influence the assessment of market opportunities:

- The general infrastructure in the country – countries at lower levels of economic development usually have less well developed road, rail, telephone and electricity systems.
- Education and literacy levels – these are usually lower in less well developed economies. Education is a high cost item for any country and the ability of a country to afford it affects the quality of education provided, the duration (say 8 – 13 year olds), whether attendance is compulsory, and what is provided free by the State and what has to be provided by pupils.
- Ownership of consumer durables – in general, less developed economies will show lower levels of household ownership of consumer durables such as cars, televisions, telephones and air conditioning systems. It should not be assumed, however, that there is no market for consumer durables in poorer countries. The way in which income and wealth are shared varies from country to country – for example, Portugal is a comparatively poor

country, at least by Western European standards, but it has a number of very wealthy families. The existence, and size, of such a rich sector in a relatively poor country represents a lucrative market for up-market consumer durables. Richer countries, with a more equal distribution of income and wealth (such as Scandinavia), might be better markets for mass-market consumer durables, but inferior for Ferrari cars and similar up-market products.

National Income

The normal way to compare the national incomes of countries is through the Gross National Product (GNP). GNP is similar to Gross Domestic Product, but it takes account of net income from abroad. GNP is therefore based on the consumption, investment and government expenditure in a country during a given time period (usually a year) plus exports minus imports plus (or minus) net income from abroad.

There are statistical difficulties in the calculations of GNPs. However, for our purposes, the figures published in, for example, the World Bank Atlas are useful, because they give good indications of income from one country to another.

GNP will be calculated in the currency of that country – for example, pesetas, yen, dollars or rand. It is usual, though, to use a common currency for comparative purposes and this is usually the American dollar. There is, then a difficulty in how the figures for GNP in each country are converted. If all currencies were exchanged at fixed exchange rates, there would be no difficulty, but as you know, the foreign exchange market is volatile. Even those currencies within the narrow band of the EU Exchange Rate Mechanism can fluctuate by 2¼%, and those currencies that float freely in the market can change considerably. Thus, while it is common to use GNP "league tables" as a general guide, it must be recognised that different positions in the league will result if different foreign exchange rates are used.

One further difference should be noted. In some countries, almost all economic activity is captured in the official statistics. In other countries (Italy is often quoted here), a substantial "black market" exists. Where work is performed but no official records are kept, the published GNP will understate the real GNP. Again, the rule is to use discretion with official statistics.

GNP records, despite their limitations, are very useful as a quick way of ranking country market sizes. The countries with the largest total GNPs in descending order are:

United States
Japan
Germany
France
Italy
UK
Canada

If we take account of the different sizes of populations we can measure the GNP per head of population. This might, in some markets, be a more useful comparative measure. When we look at the world ranking by GNP per head (or per capita), we obtain the following order:

Switzerland
Japan
Norway

United States
Sweden
Finland

Population

There are considerable variations in the population size in different countries. Population has an influence on market size, but a more important consideration is the existence of effective demand within the population and this depends upon the spending power inherent in the country.

Thus, we could list the largest populations in the world as follows:

China	1.2 billion
India	850 million
United States	250 million
Indonesia	175 million
Brazil	145 million
Japan	123 million
Nigeria	110 million
Bangladesh	109 million
Pakistan	106 million

However, although India and China have larger populations than Japan, but because their spending power is low, Japan has much larger markets for most types of product and service. Note that certain market categories are, though, very closely related to simple figures for population size – for example, food and clothing.

If we combine per capita GNP with population figures, some countries with relatively small populations are highly attractive markets in relation to their spending power, for example:

Switzerland	7 million
Norway	4 million
Sweden	8 million
Finland	5 million
Denmark	5 million
United Arab Emirates	1.5 million
Austria	7 million
Kuwait	2 million
New Zealand	3 million
Singapore	2.5 million

The accuracy of population statistics varies from country to country. Nigeria is a country that is often quoted to show the errors and difficulties in carrying out a population census. The official figures from the census of 1973 were annulled after allegations of malpractice.

Population growth is also significant. It is estimated, based on US Census Bureau data, that the population of America will increase by over 50% to 383 million by the year 2050 and by over 30% between 1990 and 2025. This is based on assumptions that levels of fertility, mortality and new immigration will remain at current levels (which might well not be correct). Most other industrial democracies forecast modest increases or declines. Spain, France, Britain and Japan forecast a growth

of well below 10%, whilst Germany is predicted to decline. From a marketing point of view, the population growth of wealthy nations is a good indicator of market growth, whereas slow or low population growth is less interesting.

The breakdown of a population into different groups is a further significant factor. Here, we can identify three significant classifications:

- ***Age*** – The way in which the age groups are distributed amongst the total population influences market opportunities. In growing populations, the percentage of babies and young people is usually high. In the slow growth populations of Western Europe, more of the population is bunched at the old and very old sections of the population.
- ***Urban/rural division*** – Urban populations have different market requirements. In addition, it is often found that urban populations are more likely to accept new products and services. This increased acceptability might result from higher levels of disposable income or it might result from fewer conservative family and tribal influences.
- ***Ethnic grouping*** –In 2050, based on the above assumptions, the non-Hispanic white population of the USA will account for 53% of the total population (down from 75% now), Hispanics will account for 21%, black Americans for 16% and Asian-Americans for 10%. The changing ethnic mix will doubtless cause many changes, not the least of which will be changing market demands for different products and services.

Geographical Influences

You should take note of differences in markets caused by the influence of climate, altitude, the nature of the terrain and so on. In a small country like the UK, it is sometimes difficult to visualise the impact that extreme heat, little or no rainfall or vast distance might have on attitudes and buying behaviour. If you consider the large population in vast countries like India or Brazil, you can see the role that these influences may play.

Import-Export Statistics

By comparing the products exported from and those imported into a country, it is possible to gain a generalised understanding of a country market. This approach is a good, quick method to screen possible opportunities, but should be followed up by more detailed, and also more expensive, market analysis before the company commits itself to that market.

Whilst it is dangerous to make a hard and fast rule, countries that are net importers of a particular product are likely to present better opportunities than those that are net exporters. In general, an export surplus will indicate a tough market to enter. An surplus of imports over exports, or perhaps the country not exporting that type of product at all, will indicate possible opportunities. These positions need to be assessed further.

A net importing country is buying in more products than it sells to other countries. This can tell us several things:

- The barriers to market entry for that country are not impossibly high. Some companies have made it, so there should be opportunities for others and the question then is how did they do it.
- Buyers in the country will be prepared to consider buying imported products.
- You can learn from the other importing companies – identifying what products they sell, the amount of product modification necessary, etc.

Note, though, that a country importing considerable quantities of the relevant type of product might, in practice, be a difficult market to enter. The existing companies in the market might be very efficient, very aggressive to new entrants, and, therefore, offer few worthwhile opportunities.

A net exporting country might be a much tougher proposition. The domestic manufacturers have shown, by their ability to sell in other countries, that they have a measure of expertise. They might be so expert that they leave no easy or profitable market opportunities in their own country. Existing companies selling into the country might be well established and have distinctive competencies that may be difficult to match – for example, in respect of developing leading edge technology, having significant patent protection or well-developed high quality customer relationships and marketing programmes.

H. ABSOLUTE AND COMPETITOR ANALYSES

Although comparative analysis predominates in the development of international business plans, businesses also need to consider aspects of a market in its own right. Thus, a large and growing market size may be sufficient on its own terms to override negative comparisons with alternative markets. This approach is known as absolute analysis.

A further form of analysis of a market on its own is competitor analysis. This is crucial to the development of specific international business plans and should run throughout the process of planning from the identification and selection of target markets through to the development of specific marketing action programs.

Absolute Analysis

As the term implies, this analysis looks at markets as entities in their own right rather than necessarily comparing them with, say, home markets in the assessment of business opportunities. So, for example, a market which on a comparative basis may appear to be unattractive may, in an absolute sense, constitute an extremely attractive market to a company.

This is true, for example, in respect of many of the markets in developing countries. Looked at comparatively, aspects such as culture, levels of disposable income and the types of economic activity might be very unfavourable compared to the business's own domestic, developed markets. However, just one factor – say, for example, the size of the population in the developing market – may be such as to make this market very attractive.

Here we can see that one individual "absolute factor" may be instrumental on its own in either attracting, or alternatively, deterring a business from considering marketing in that country. Therefore, although comparative analysis is an important and key step in the development of specific international business plans and particularly in accessing and targeting marketing opportunities, the business must use such comparative analysis with care.

Competitor Analysis

Perhaps the most important single factor influencing the relative attractiveness of an overseas market is the nature of the competition in that market. Often, this factor may be important enough to override all other factors in market attractiveness. So, for example, a business may, on the basis of many of the elements contained in a comparative analysis, feel that a particular market looks very attractive – i.e. it may have a similar culture to the business's other markets, may be at a similar stage of development, and may have education and literacy levels which favour the business's product range. However, all of these otherwise favourable factors may be outweighed by the fact that the market is dominated by one or two very large competitors who would react very strongly to any attempts by the

would-be overseas newcomer to enter the market. Of course, this can work in reverse in as much as the competitive situation may render an otherwise relatively unattractive market extremely attractive, where, for example, the marketer faces little or no competition.

A key part of analysing any overseas market is, therefore, an analysis of the nature of competition, including the competitive market structure prevailing. Competitor analysis is hugely important to the selection of international target markets.

Study Unit 7

International Business and Marketing Strategies

Contents ***Page***

INTRODUCTION

Having considered the environment of international business, and identified and analysed opportunities in that environment, we now move on to look at the way in which companies decide what they are trying to achieve and how they might get there. This involves the development and agreement of objectives and the consideration of different strategic options.

In this study unit we will review the international planning process and consider the main elements and decisions of strategic international business and marketing plans. This also sets the background for many of the following study units.

We start by exploring the need for a planned approach, the different planning stages and the key elements of international business and marketing plans, together with some of the difficulties associated with planning for international markets. We concentrate on the key decisions in the international business and marketing and some of the major factors that will serve to influence and shape these decisions. Throughout, we emphasise the additional complexities and issues which arise compared to developing purely domestic plans. Important options for the international business include, for example, the importance of non-domestic sales to the company, the range of countries, selection of individual countries and modes of market entry. Once these decisions have been made, the business must further consider options with regard to standardisation and adaptation, the marketing mix, and implementation and organisation – issues which we shall continue to explore in Study Units 8 and 9 which follow.

A. BUSINESS PLANNING

The process of business planning is concerned with forecasting the future and deciding what changes to implement to take the best opportunities and minimise the main problems.

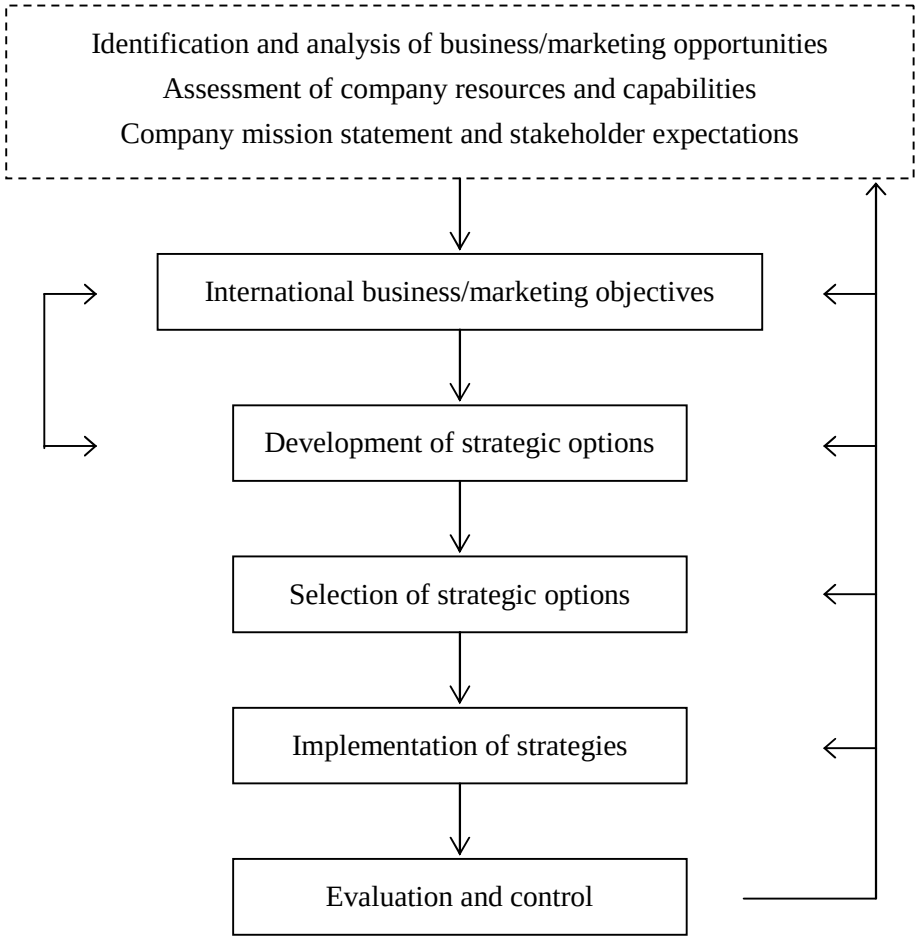
Objectives are an important foundation for the planning process. The organisation needs to decide what it wants to achieve. What it can achieve will be determined in part by the selection of the main means of getting to those objectives. These main means we refer to as strategies. If poor quality strategies are selected, it will not be possible to achieve good sales and profits results. The level of the objectives that can be set realistically will be strongly interrelated with the strategies that are identified. Other factors are, of course, influential in the actual levels of sales and profits that are achieved. The quality of the implementation is one factor. The accuracy of forecasting the future is another factor. The nature and intensity of competitive actions are yet another important factor.

It is important for companies of all sizes to plan their international activities. It is very wasteful to rely on reaction as a management process – for example, opportunities might come and go before the reactive company tries to implement a considered marketing mix aimed at meeting the needs of a specific international market. In large and complicated organisations, planning becomes even more important as a means of co-ordinating and integrating the geographically spread organisation.

The Planning Framework

The process of developing an international business/marketing plan is shown diagrammatically in Figure 7.1. You will recognise that the main elements of the framework are essentially the same for international planning as those found in purely domestic business.

Figure 7.1: The planning process



(a) Analysis of strengths and weaknesses – the company mission statement and stakeholder expectations

As in all strategic planning, the process starts with the analysis of strengths, weaknesses, opportunities and threats. This involves the identification and analysis of markets in which the company can effectively compete and therefore includes an assessment of company resources and capabilities. We have discussed the importance of the analysis of marketing opportunities in earlier study units. Through marketing research and intelligence gathering activities, the business must seek to achieve a strategic fit between the company's capabilities and the opportunities presented by a dynamic environment.

At this stage, the company should also consider the its mission statement and stakeholder expectations. These concepts serve both to shape and constrain business and marketing strategies. In the international market, of course, stakeholders must include not only domestic country stakeholders but also those of any host country in which the international business operates. This would include, for example, local employees, pressure groups, host country governments and host country communities. Obviously having such a potentially wide range of stakeholders to consider in international markets makes this task that much more difficult.

(b) International business and marketing objectives

This stage of marketing planning involves the company determining what it wants to achieve. Without clear objectives, an organisation is unable to delineate and select between strategies,

nor to evaluate the extent to which desired outcomes have been achieved. Remember that objectives should ideally be "Specific, Measurable, Achievable, Realistic and Timed" (the SMART criteria).

When it comes to international business the company must not only decide what sales and profits it wishes to generate from international operations, but also the related issue of, for example, what degree of involvement and commitment the company wishes to achieve for its international operations.

(c) Development of strategic options

This stage in the development of the international marketing plan involves identifying the broad strategic routes which a company can select between in order to achieve its objectives. There are a number of ways of thinking about strategic options and a number of models of strategic alternatives have been developed. Perhaps one of the best known of these, however, is again one which you will probably be familiar with and indeed can be used in both domestic and international markets, namely the Ansoff Growth Matrix. We look at the use of this in the next section and consider other issues to do with strategic options in the rest of the unit.

(d) Selection of strategic options

Having identified the strategic options, the next step is to select those that are most appropriate. A number of considerations are important here. Obviously the options must match the company's resources and capabilities and the company's mission statement and stakeholder expectations. The options must also be assessed with regard to risk and investment requirements, etc. Needless to say, the options selected should be those that enable the company to meet its international business objectives in the most cost-effective way.

(e) Implementation

The implementation stage involves decisions about the nature and application of operational activities designed to meet the business's objectives. This involves acquiring and deploying the resources necessary – financial and human – and establishing the organisational structures and management systems which enable those resources to appropriately applied in the pursuit of the company's objectives.

It will also include designing and implementing the elements of the marketing mix – we shall be considering this aspect of the international marketing plan in some detail therefore in later study units.

(f) Evaluation and control

The final stage in the framework is the assessment of the extent to which the plan has worked and objectives have been met. Control involves the measurement and analysis of performance against evaluative criteria established as part of the objectives, and the taking of corrective action.

Recently, research and literature on planning strategies in practice has illustrated the fact that very often actual strategies arise in very different ways to the "text book" planned fashion of a sequence of logical and intended steps as set out above. Instead of planning being a linear and systematic approach, it is suggested that much strategy arises as a result of companies' actions over time. There are many reasons why this happens, but the intended strategy can be changed as a result of changes in the business environment such as cultural and political changes which in turn require changes to the intended and planned strategy.

Of course, it could be argued that such changes should themselves be planned for in the intended strategic plan through the use of contingency planning. Any "surprises" which force the business to change plans in mid-stream, therefore, could be looked at as a failure or deficiency in the planning systems. However, a number of factors make such surprises and changes to intended strategies more prevalent these days, and more importantly, more appropriate to effective marketing. These two factors are the increasingly dynamic nature of the international business environment as we have discussed in earlier units, together with the ability of organisations to access ever increasing amounts of detailed information through on-line systems, again as discussed earlier, and thus make speedy decisions.

Taking the first of these, the dynamic nature of the international marketing environment, the speed and pace of change in this environment puts an increasing premium on companies being flexible in their planning systems rather than developing plans and then sticking to these whatever the circumstances. The pace of change in the environment requires that management be alert and responsive to these changes and be able to incorporate them in modified strategies. Indeed, speed of response and flexibility are key facets in competitive international business strategy. Such "emergent" strategies, as they are often referred to, are based on the notion of organisational learning over time.

Effective strategies, therefore, are based on managers being sensitive to environmental signals through environmental scanning and by evolving strategy in small-scale steps to match these. Clearly, there is a danger in this approach that companies are pulled off target and away from their intended objectives and strategies, a process sometimes referred to as "strategic drift". This can result in companies simply "muddling through" a series of crisis changes as the organisation is battered by the vagaries of a stormy environment. Needless to say, such an ad hoc approach to planning is not to be recommended.

Approaches to Planning

The way in which organisations approach the issue of planning may differ as follows.

(a) Planning and the organisational hierarchy

There are three main ways in which the planning process may be undertaken:

- The ***top-down planning*** approach is one in which the most senior managers prepare broad strategic plans and then rely on local managers at country level to implement the plans.
- ***Bottom-up planning*** is the reverse process. Here, managers at country level prepare their plans, which are then passed on to the central headquarters for senior managers to adjudicate. This approach uses local knowledge and encourages local involvement, but can be time-consuming before the final plan is agreed. It can also be frustrating if the local plan is extensively modified or even rejected in total.
- In an attempt to gain from the positive features of top-down and bottom-up planning, some companies use ***goals-down, plans-up planning***. This approach aims to achieve a blend of consistent strategic planning through setting objectives or goals and deciding the main strategic options with the locally developed and implemented plans.

(b) Moving towards strategic planning

Even though there are differences, the development of a planned strategic approach to domestic markets and to international markets might well evolve through approximately the same stages.

These stages are:

- ***Unplanned stage***

  The company manages in a reactive way without a planning process or a formal written plan.

- ***Budgeting stage***

  The company develops a plan, but the plan is primarily composed of numbers which have little justification from business and marketing research or market opportunity analysis. The figures in the budget reflect financial forecasts of sales, cash flows and profits. These figures are often projected from past results. The great weakness with this approach is that it makes little attempt to forecast what customers will want to buy in the future.

- ***Annual business and marketing plan stage***

  This approach to planning shows a considerable improvement on the budget stage. In an attempt to gain more accurate forecasts of the future and to involve managers actively in the planning process, the next stage in planning is reached. The plan is developed across the business functions of production, finance and marketing but is often limited in time-scale to the next financial year.

- ***Strategic planning stage***

  This approach to planning takes a longer-term perspective. Whereas the earlier approaches will be based on a one- or two-year cycle, strategic planning will operate over five to ten years or maybe longer. This longer-term plan is much more appropriate for international business because it often takes a long time after entering a country market before substantial market shares are established. An important step in good strategic planning is to build the more detailed annual planning into the overall strategic direction. If this is achieved, it avoids the annual plan being a tactical implementation of something that is always remote from the long-term strategic plan.

Benefits of Planning

The benefits of planning include the following:

- The company is encouraged to be proactive rather than reactive. It tries to anticipate environmental change, changing buyer needs and wants and competitor activities. It is most unlikely that the company will forecast the future with total accuracy, so it will, therefore, have to react to some unforeseen events. It is obviously better to plan proactively and take the benefits from this approach and to confine reactive activities to those areas that were not anticipated.
- Planning encourages the involvement of many international personnel in a process of analysis, discussion and decision. The end result should be one of improved decision-making about the need for future activities. It should also provide some sense of ownership in the final international business and marketing plans.
- The clear statement of time-scaled objectives and the strategies to be employed to achieve those objectives should prevent misunderstandings and delays in the implementation of plans in different country markets around the world.
- There is the opportunity to develop consistent marketing information systems to help inform decision-making.

- The evaluation and control of implementation will be easier if there is a consistent process and written-down plan.

Difficulties of Planning in International Markets

If there are many benefits to international business planning, there are also many difficulties. In fact, international planning poses several difficulties and complexities over and above those encountered in purely domestic marketing. Some of the reasons for this added difficulty and complexity are listed below:

- The planning process is done at a distance from where the plans are implemented.
- Planning is done in the context of an unfamiliar environment.
- Related to the above, the planning must encompass different cultures.
- Information is more difficult to obtain.
- The political environment is often much more uncertain.
- Different stakeholder expectations have to dealt with.
- Evaluation and control are more difficult.

B. STRATEGY DEVELOPMENT

The Ansoff Growth Matrix

The Ansoff growth matrix can be used to explore the different strategies open to a company around markets and products, as shown in Figure 7.2.

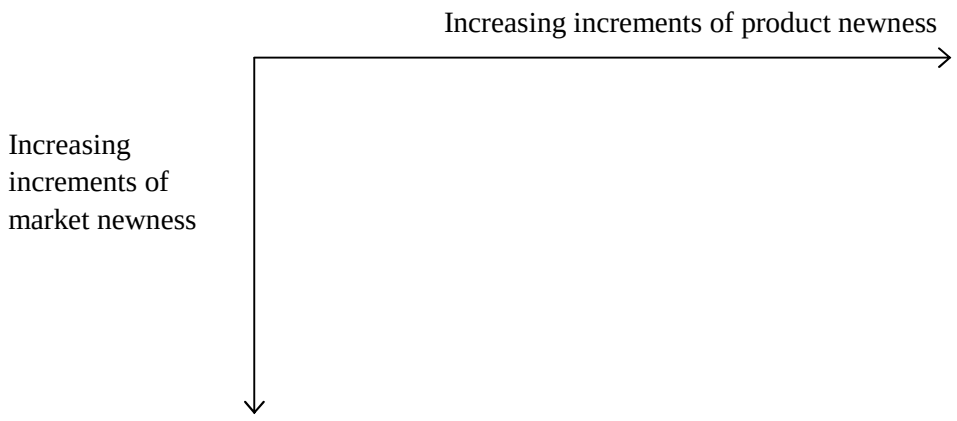
Figure 7.2: The Ansoff growth matrix

	EXISTING PRODUCTS	NEW PRODUCTS
EXISTING MARKETS	Market Penetration	Product Development
NEW MARKETS	Market Development	Diversification

From an international perspective, growth can often be obtained by developing into new country markets through the strategy of market development. It is particularly risky to attempt to launch new products into new markets, and this is particularly the case in international markets. However, the degree of risk will vary according to the degree of difference between the existing market and the new market, and the existing product and the new product. A useful way to visualise this is by developing the Ansoff growth matrix from its standard four-cell format to a multiple, incremental scale on both the market and the product axes.

This modification can be used when considering options and assessing strategies for entering new international markets. This adapted model is often referred to as the ***Ansoff Incremental Matrix***. This is shown in Figure 7.3 below:

Figure 7.3: The Ansoff growth matrix using an incremental scale



The idea of this matrix is that it is possible to assess different degrees of risk in entering new international markets by considering degrees of market newness and product newness. So, for example, it will be more risky to launch a product into a new country with considerable distance, both geographically and culturally, from the country markets that the company is used to. For example, a UK company that has developed markets in the EU will experience higher risks in marketing to Latin American countries or to Japan and China than it would to Turkey and Switzerland. All the countries mentioned would be new markets, but Switzerland and Turkey are closer geographically and culturally than the high context and geographically distant Latin America, Japan and China. Entering these markets therefore would be a very high risk strategy, particularly if it were combined with the need to produce entirely new products.

Key Strategic Decisions Areas

Although Figure 7.1 shows the key elements of an international business and marketing plan, it does not tell us what the key decisions are in developing the plan, and in particular those decisions which are special or different when considering the planning of international as opposed to purely domestic business and marketing. In this section, therefore, we shall examine these special decision areas, focusing on them in the sequence in which they arise in strategy consideration for the international business. (In the forthcoming sections, we shall consider the impact of a number of features and factors on these decision areas.)

(a) The importance of non-domestic sales and profits

This first decision for the business concerns the extent to which non-domestic sales will contribute to overall company sales and profits. Obviously a company that decides that this contribution is to be zero will not get involved in international operations at all. On the other hand, the company that determines that non-domestic sales are to contribute the bulk of sales and profits over time will have a very different approach to strategy and planning in the international arena.

(b) The range of countries selected

This decision area is concerned with the extent to which the company will concentrate its marketing efforts on one, or perhaps a few, selected international markets, or whether it will attempt to target many markets throughout the world. Essentially this decision is the same as the segmentation and targeting decision encountered in any marketing planning process. So, for example, a company can choose between a range of targeting strategies as follows:

- A concentrated targeting strategy – i.e. targeting only one selected country.
- A targeting strategy based on marketing in several countries which are possibly related in some way – for example, member countries of the European Union.
- A targeting strategy based on selecting any country in the world which is assessed as providing a marketing opportunity – i.e. a global targeting strategy.

Obviously, many factors will affect this decision including, for example, company resources, company objectives, experience (or lack of it), etc.

There is some evidence to suggest that companies which concentrate their international marketing efforts on fewer countries tend to be more successful compared to the company which spreads itself too thinly across different international markets.

(c) Selection of individual countries

Having determined whether to opt for a concentrated or market spreading strategy, again, as in any marketing plan, the business must decide which specific markets to target. Again, this decision is no different to that encountered in purely domestic marketing, and many of the considerations are the same. The characteristics of an attractive international target market include, for example:

- Market size and potential
- Extent of competition
- Some relatively unsatisfied customer needs which the company could satisfy

In addition to these basic characteristics of an attractive market target, however, the following considerations in assessing market attractiveness come into play when we consider international marketing:

- Nature and extent of trading barriers
- Physical and geographical ease of access
- Political and economic stability
- Currency and exchange risks

Understandably, very often companies will initially choose target markets which are similar to their own domestic markets and/or are geographically in close proximity. Ideally, however, again as in the selection of any market target, a careful analysis of the business opportunities offered by the markets should be conducted.

(d) Mode(s) of market entry

Having determined which markets to enter and the concentration or spread of these markets, the business must next decide the way of entering these markets. We shall consider this important aspect of international marketing in more detail later in the course, but we shall consider the key characteristics and importance of this decision here.

The mode of market entry is probably one of the most important decisions that the international business has to make. This decision affects all of the other functions and aspects of the strategy and programme including, for example, the type and extent of resources required, the most appropriate form of organisational structure, the design of the marketing mix, and so on. As we shall see later, there are in fact a myriad of alternative ways of entering an international market, but broadly, we can distinguish between two major alternative routes. The first of these involves a company entering a market through some sort of ***exporting arrangement***. The alternative is through some sort of ***foreign ownership***. Again we need not concern ourselves with the specific mode of entry alternatives under each of these broad categories because they are examined in detail in a later study unit. At this stage it is sufficient to note that the mode of market entry is one of the most important and pervasive decisions in the international planning process.

(e) Standardisation and adaptation

As you have probably already guessed, this decision area in the international strategic planning process involves decisions regarding the extent to which business strategies and programmes will be adapted to different markets/countries, particularly with reference to marketing considerations. As we shall see in later study units, these decisions encompass not just standardisation and adaptation with regard to the elements of the marketing mix, although these are key decisions in this area, but also decisions as to the extent to which, say, organisational structures, systems and procedures will vary throughout the different countries or markets which a company operates in. As with mode of market entry decisions, this area is so important in international marketing that a whole study unit, Study Unit 9, is devoted to this area. In addition, we shall see that issues of standardisation versus adaptation run throughout the study units which encompass the marketing mix elements of the international marketing. We shall therefore return to this area several times throughout the rest of the course.

(f) Marketing mix

Again, this decision area and the activities involved in planning the marketing mix are no different to those encountered in purely domestic marketing. The business therefore must decide about the four (or possibly seven) Ps of the marketing mix. Obviously, decisions about these elements are affected by, and should reflect, the earlier decision area with regard to standardisation versus adaptation, but the business will still have to decide overall broad strategies for each element of the mix within this context.

(g) Implementation and organisation

This final area of decision-making involves decisions about how to implement strategies. It therefore includes decisions about detailed action programs and encompasses the more tactical, but nevertheless crucial, aspects of international marketing. This decision area also encompasses issues regarding organisational aspects such as the most appropriate structures and staffing arrangements for achieving objectives.

C. STRATEGY AND COMPANY FACTORS

The first set of factors affecting the key decision areas outlined in the previous section are those relating to the company itself. Examples of company factors which will affect the range and choice of strategy options include:

- Size, strengths and resources.
- Orientation: ethnocentric, polycentric, regiocentric and geocentric.
- Type of involvement in international marketing: exporting, international, multinational and transnational.

Obviously, these company factors will in various ways affect the previously discussed key decision areas – so, for example, the smaller company with fewer resources is more likely to have a concentrated targeting strategy with regard to the selection of overseas markets. However, it is dangerous to make a watertight link between the different classifications. For example, it would ***not*** be correct to say that small companies ***inevitably*** have concentrated targeting strategies, regard international business as important or are likely to be ethnocentric companies involved only in exporting.

We shall now consider each of these company factors in more detail.

Size, Strengths and Resources

A company will be constrained in its choice of international strategies by its size and the availability of resources. Of particular importance in this respect are the financial implications of different strategies.

One of the reasons for the growth of Japanese companies in international markets is that they have had better access to resources, including financial resources. They companies are less subject to the short-term stock market pressures that are so influential for UK and US companies, and this, when translated into possible strategic options, has meant that Japanese companies have been able to undertake longer-term growth-oriented strategies. US and UK companies have been more restricted. Smaller companies are also restricted – for example, budget sizes for advertising and sales promotional support will be smaller and the number and calibre of people to support international marketing operations is often restricted.

Companies also differ, of course, with regard to their strengths. Understandably, when it comes to identifying and selecting international markets, the business should be looking to match company strengths to the most attractive markets. A useful approach linking company strengths and the attractiveness of different country markets has been developed by Harrell and Kiefer (1993). Country attractiveness is measured by criteria such as market size and growth, economic and political stability and the lack of tariff and non-tariff barriers. Company strengths are measured by criteria to evaluate the relative competitive position, the degree of co-operation to be expected from distribution channel members and the fit between the existing range of products produced by the company and the need to adapt products to make them acceptable in the country market. The market share available for the company in the country market is also usually very important because it influences the economies of scale and experience that can be gained in that market.

The country attractiveness/company strengths matrix can also be used to help identify suitable strategic options. Countries that are, in themselves, highly attractive and which overlap with countries in which the company already has a high strength, will be countries in which the company should develop strategies for investment and growth. On the other hand, countries with low attractiveness in

which the company has few strengths, will require strategies to harvest the profits that are available or the company should consider selling off its interests in the market.

Figure 7.4: The Harrell and Kiefer country attractiveness/company strength matrix

		Company Strength		
		High	*Medium*	*Low*
Country Attractiveness	*High*	Invest/Grow		Dominate/Divest/ Joint Venture
	Medium		Selectivity	
	Low	Selectivity		Harvest/Divest

Companies might well wish to develop their own modified versions of the Harrell and Kiefer Matrix using their own criteria with regard to what constitutes the important elements underpinning country attractiveness and company strength..

Orientation

In an earlier study unit we discussed the different orientations towards international business which a company can have. We called this the "EPRG" (ethnocentric, polycentric, regiocentric and geocentric) orientations approach and it is useful because it helps us to understand possibilities and limitations caused by the prevailing culture or orientation within the company.

- Companies with an ethnocentric orientation are unlikely to be culturally sensitive to the needs of non-domestic customers. They are likely to develop strategies that are influenced too strongly by their own national experiences. In some situations this can develop a strong consistent strategy; for example, champagne from France or fashion clothing from Italy. In other situations, opportunities are lost because the strategy does not allow the possibility of adaptation.
- Companies that follow a regiocentric orientation are likely to miss strategic opportunities outside their region. A European company following a regiocentric approach might be strong in Europe but miss the growing market opportunities in Asia.
- The polycentric-orientated company will have strategies with highly tuned adaptations to host-country markets Its weaknesses will revolve around missing standardisation opportunities and the lack of an internationally co-ordinated competition strategy.
- The geocentrically-orientated company should be capable of developing a wide range and balance in its international business strategies. It can plan globally, but develop relevant country and world-region adaptations.

Type of Involvement

Remember that companies have different degrees of involvement in international business. One way of classifying such involvement is to distinguish between exporting, international, multinational and transnational business/marketing. Each of these, together with their implications for some of the key decision areas in marketing strategy which we have outlined, is discussed below.

(a) Export business/marketing

Exporting involves simply the physical movement of products across country boundaries. This is the lowest level of commitment and therefore can encourage companies to develop a market spreading strategy without formally evaluating the benefits to be obtained from key market concentration. In export business, many companies do not have a clear strategic plan – opportunities are exploited in a more entrepreneurial way. The company usually limits its long-term commitments to any one market. Country markets might not be selected by a careful analysis of opportunity but might be more influenced by the ease of dealing with the markets. In this way, British companies have often selected Commonwealth countries. It is only relatively recently that Continental/European markets have been the main focus for British companies.

Exporting companies will rarely have a specific strategy towards standardisation and adaptation. The product is usually the same product as for the home domestic market. Products are developed for the home market and then exported if there appears to be potential. It will be necessary to adapt products to make them acceptable in different countries with regard to laws, technical standards, climatic conditions, cultural factors and so on.

The other elements of the marketing mix will change in different countries, but usually without any overall co-ordination. If agents and distributors are responsible for marketing communications, large differences may develop between the messages and the positioning in each market.

(b) International business/marketing

In international business and marketing, the company will, by definition, use market entry modes that include sales and distribution depots in other countries and they might include a complete production and marketing operation. There will be a greater range of strategic options possible and the company is more likely to formalise its international business and marketing planning. It is possible that this planning will be limited to annual budgeting although such companies are increasingly taking a longer-term and more strategic view of their planning processes.

(c) Multinational business/marketing

The importance of international sales and profits becomes larger and larger as the company expands its international exposure. Multinational enterprises (MNEs) have direct foreign investment in a number of countries. Different writers on the subject quote different numbers of countries. However, to be an MNE the company must have at least one other major country operation.

The planning process becomes much more formalised. The high costs and risks associated with direct foreign investment mean that the company must take a long-term view. There will be a more formal approach to country selection. The selection of certain countries for investment is likely to bring with it a market concentration approach. It is, however, possible that companies could separate their production operations from other strategic considerations, including

marketing. The low cost advantages of certain countries might result in their usage as an operations site rather than as a key market.

The MNE in its standard form has a polycentric orientation. This results in a low level of standardisation because each subsidiary, as it becomes more entrenched within the culture of the host country, seeks to adapt the centralised plans developed at the headquarters of the company. Often the product will remain standardised, but the other parts of the marketing mix will be subject to adaptation. This variability in approach and the subsequent higher costs that result from the diversity of methods and the marketing mix, have made the MNE vulnerable to aggressive local competition and to competitors that operate from a more co-ordinated global perspective.

(d) Transnational business/marketing

A recent trend has been the move of MNEs towards a more global approach. In its pure form a transnational company would develop international strategies based upon a thorough assessment of market opportunities around the world. The transnational would then configure its activities in order to exploit those opportunities to the full. It would not be tied to any one country or world region. It would be culturally neutral in the way that it evolved and implemented international strategies.

It is exceedingly difficult, though, to develop a true transnational company in the way described. Most very large MNEs are moving away from a polycentric orientation towards a geocentric orientation, but to change the culture of an organisation takes time. The company is usually "locked" into various countries because of decisions taken previously in its history.

Our view of transnational business and marketing is more evolved than most companies have been able to reach so far. For the pure transnational company, international strategies will be based on a careful calculation of opportunities around the world, paying particular attention to the importance of the triad markets and to other parts of the world where growth opportunities are significant. For many companies the growth opportunity markets are countries in Asia and Central and Eastern Europe.

The likely strategy characteristics of these different types of company are summarised in Table 7.1.

Table 7.1: Likely characteristics of international strategy by type of involvement in international business

	Export Marketing	**International Marketing**	**Multinational Marketing**	**Transnational Marketing**
Importance of Non-Domestic Sales	Varies but is often small.	Becoming more important.	More important.	Very high importance.
Range of Countries Selected	Often based on geographically or culturally close countries.	More formal country selection.	Careful selection because of foreign direct investment.	Selected on a worldwide and market importance basis.
Market Concentration or Market Spreading	Often market spreading.	Market concentration becomes more important although, as the company size expands, more countries will be entered.		Resources are allocated on a world strategy.
Standardisation or Adaptation	Product the same but adapted to local conditions. Other elements are usually adapted.	Considerations of standardisation and adaptation are examined.	Aims to be centralised and therefore standardised but considerable adaptation by subsidiaries.	Formalised to gain global and local benefits.
Product Mix Used in Different Countries	Will vary from country to country.	More experience and resources used internationally will permit more control of the product mix.	Tendency to be similar to the headquarters country but with local adaptations.	As above.

D. STRATEGY AND COMPETITION

We have already examined the probable weakness that a company will have when it enters new country markets. In its own domestic market, a company will, if it survives, gain a better understanding of its customers and its competitors – this enables it to build its sales. In new country markets, it has to start again from the beginning – it has to contact customers for the first time; it needs to develop a customer base. Whilst doing this, the company has to compete with companies that are already established within that market.

Analysing Competitors

There are a variety of ways in which we can analyse competitors. There is no one way in which we can fully understand them, but a combination of approaches can be very helpful in understanding the influence that they might have on a business's activities.

(a) International and segment coverage

The first approach is to look at the international scope of competitors and their market segment and industry coverage. This can be realised through considering their place on the type of matrix shown in Figure 7.5.

Figure 7.5: Competitor analysis – By international coverage and degree of specialism

	Domestic	International	Global
Specialist – limited to one or two market segments			
Generalist, including specialist expertise – covering all the main segments in an industry			
Multi-industry			

It is easy to identify competitors who operate within just one domestic market. Some companies operate more internationally. Global coverage is more difficult to define. To be global, a company would need significant involvement in at least two, and preferably three, of the triad markets.

(b) Competitive positions

Within any country market a company will occupy one of several possible competitive positions. Kotler identifies four different competitive positions – market leader, market challenger, market follower and market nicher:

- The market leader has the largest share of the market.

- The market challenger has the second largest market share and is usually striving to increase it.
- Market followers have smaller market shares, but are still significant players. They develop strategies to conserve their existing market position and, thus, rarely undertake marketing activities that are aggressive in taking market share from the market leader or the market challenger.
- Market nichers concentrate on the small market segments that make up the total market of most consumer or business markets.

Generic Competition Strategies

According to Michael Porter, there are three generic strategic approaches designed to outperform other companies in an industry. These are lowest cost position, differentiation and focus.

(a) Lowest cost position strategy

This is usually used by companies that have the largest share of a defined market. Whilst sheer size, through the economies of scale and the experience curve effect, offers the opportunity of lower costs, it does not necessarily give a cost leadership position. The lowest cost position, the cost leadership position, can sometimes be claimed by companies that are particularly efficient in managing their affairs. Cost leadership does not mean having lower expenditure than competitors. If a company has a higher level of sales, it can achieve cost leadership if its costs per unit sold are lower than competitors. For example, advertising, research and development, marketing research and sales-force costs need to be considered as a cost per unit sold, in addition to the total cost. Companies selling large volumes of product will gain advantages over smaller companies because they can reach the minimum threshold levels of most, if not all, strategic options, and for most options they will have lower costs per unit.

The lowest cost position in the past was measured within a national domestic framework, but increasingly, industries are developing on a world scale. This means that cost leadership has to be viewed more from a global than a national perspective. Japanese companies have been particularly forceful at developing international strategies that drive for increased market share. Increased market share allows lower costs to be achieved. If this is applied to a constant drive for quality and for efficiency, a powerful position is built up. Japanese companies in the car, motorcycle, camera and hi-fi industries have achieved international positions based on cost leadership.

(b) Differentiation strategy

This is a generic strategy that operates on an industry-wide multi-market segment approach that relies on customers regarding the product or service as unique. Customers provide the protection for the company in the differentiation approach. If customers regard Mercedes cars as high quality and high status cars which cannot be equalled by other car makers, then Mercedes can defend its market share position. It is a strategy that will give above-average industry profit returns. If Benetton's publicity approaches, their closeness to the market in response to fashion trends and colours, and their efficiency in managing the whole process of new product development to retail availability to the customer, enable the customer to think of Benetton as an unrivalled source for their fashion clothing, then Benetton will be successful. That success will be based on a differentiation strategy. Coca-Cola and Pepsi Cola use differentiation strategies in their international marketing strategies.

(c) Focus strategy

This is based on finding a particular market segment and serving that segment more successfully than other competitors. Because the segment is one of other segments in the market, the focus or niche strategy cannot give the lowest cost position. The large volume producers with large market shares of the total market will have lower costs than the niche strategy company. Internationally, the niche strategy depends on finding similar small market segments in other country markets, particularly if those segments are not well served by companies at the present time.

Porter quotes the example of Montblanc, the German producer of high quality pens, as a company with a global focus strategy. In the past decades, a number of Japanese companies that have since moved on to become global companies on a multi-segment basis started by attacking markets on a narrow segment basis. Porter notes, "In industries such as cars, lift trucks and television sets, for example, Japanese firms established initial beach heads by focusing on the compact, and neglected, end-of-the-product range. They later broadened their lines and gained commanding worldwide positions" (Porter, M.E. (1990), The Competitive Advantage of Nations, MacMillan).

Competitor Defence and Attack Strategies

Companies in international markets usually operate from a market challenger, follower or nicher position in individual country markets. It is only the well established companies that will have market leadership positions in countries other than their own domestic market. If a company wishes to gain market share in other country markets, it can either aim to increase sales in a rather general way or it can try to attack the business of established competitors.

Most strategic thinking related to competitor defence and attack strategies is based upon military strategies. A major idea in attack strategies is that of "mass". It is important to concentrate resources at particular points and at particular times in order to achieve results. There are a number of attack strategies, the main ones being frontal attack, flank attack, guerrilla attack and bypass attack.

(a) Frontal attack

This means taking the competitor on across the whole range of the marketing mix and in most country markets. In its pure form, it is most unlikely in international business. It is much more likely that a frontal attack strategy will be used on a country basis. In this way the attacker can concentrate its resources. On the full international front it would be too expensive to mobilise enough resources of people, budgets and product to attack in sufficient force to achieve any real effect. The net result of such a manoeuvre would be substantial losses to the failed attacker.

Companies that have used the full frontal attack strategy have usually achieved a cost leadership position, whilst still being a market challenger, and then used the cost advantage to build resources to attack the market leader.

A modified form of frontal attack can be developed by companies using a price-aggressive strategy, whilst matching the other elements of the market leader's marketing mix.

(b) Flank attack

This strategy has been used frequently in international business. Defenders will concentrate their resources where they most expect to be attacked. This might be a particular country or group of countries, it might be a particular market segment, or it might be through one of the elements of the marketing mix. Accordingly, attackers will be more successful if they can find less well defended positions. The strongest defences will usually be with the big important

countries, in the main product line and with the biggest customers. The weaker points, the flanks, will usually be in the less prestigious areas.

Japanese companies attacked the flanks of UK and US industry in the motorcycle industry through marketing very small capacity motorbikes. In the television industry they marketed, initially, small size black and white televisions when the UK and US industry interest was centred on larger colour sets. Once the Japanese companies had established a distribution channel foothold in the UK and the US, and they had begun to understand buyer behaviour and the dynamics of the marketplace, they started to introduce other, more directly competitive products.

(c) Guerrilla attack

This is an approach which might be suitable for companies with fewer resources than those attempting flank and frontal attacks. The guerrilla strategy is to make small, unpredictable attacks in various geographical locations on an opponent. The aim is to unbalance an opponent so that in the longer term significant advantages can be gained.

In the short term it is imperative that the cost of guerrilla attacks is less than the damage inflicted on the opponent. Guerrilla attacks will usually be based on selective price cutting and marketing communications activity.

(d) Bypass attack

This approach avoids direct confrontation with opponents. One type of bypass approach is to enter country markets that are not currently served, or are very weakly defended, by your main competitor. Thus, if your main competitor is strong in Europe and North America, a bypass attack might be made by concentrating on, say, India and China – countries in which your opponent has no representation.

Another type of bypass attack is to channel resources into research and development to develop new technologies to replace the existing products on which your competitor's strength is based. In the 1960s the UK company, Wilkinson Sword, developed razor-blade technologies based on stainless steel. In a few years Wilkinson had gained a significant share from Gillette, the world leader in the razor-blade market. Gillette for some years clung to carbon steel blades which were sharper, but less long-lasting than Wilkinson's stainless steel blades. Unfortunately for Gillette, customers preferred to have more shaves from a slightly less sharp blade. Without this bypass attack, it is most unlikely that Wilkinson would have penetrated the markets that were dominated up until that time by Gillette.

E. STRATEGY AND LEVEL OF ECONOMIC DEVELOPMENT

Economic factors are part of the SLEPT and C influences on the environment of business, and they play a major role in influencing, directly or indirectly, many of the other factors – social, legal, political and technological. They also directly affect such elements of the environment as market size and growth. The type of economy, therefore, strongly influences the "rules of the game" in the country market and strength of buyer demand – important influences on international business and marketing strategy.

In a world of over 200 countries, in which the economic factors show considerable variation, it is clearly necessary for business and marketing to recognise their impact. Taken to its logical conclusion, though, this could mean that a company would need to produce a different marketing mix

for each country. This is likely to be impractical even for the largest and wealthiest companies and most would resist this amount of change and adaptation to the particular needs of a country market. They would prefer to take a more standardised approach, wherever possible, in order to cut costs.

One compromise approach is to group or segment the world market by the level of economic development. In this way countries could be segmented, as we have seen before, as follows:

- ***Industrially advanced countries*** – these would include the US, Canada, the UK, France, Germany, Italy and Japan.
- ***Newly industrialised countries*** – these would include South Korea, Singapore, Taiwan, Malaysia and Mexico.
- ***Developing countries*** – these would include most countries in Africa, Asia and South America. Since the break-up of the Communist bloc in 1989/90, many of the Central and Eastern European countries would appear in this category.

The implications of this division for the development of strategic plans are discussed below.

Industrially Advanced Countries

For most product markets, the industrially advanced countries will represent the most important markets. In many product markets, 80 – 90% of the world market will be bought in these countries.

Industrially advanced countries will have a comprehensive infrastructure of transport, power and communication systems, together with a workforce and marketplace that has high literacy and education standards. These standards will, of course, vary – Japan, for example, has a particularly strong educational system.

These countries will have low levels of risk as measured by risk evaluation agencies (e.g. BERI, the Economist Intelligence Unit). The result of this is that investment decisions will be regarded more favourably than they would be for countries classified as more risky.

The level of market sophistication and the high likelihood of established national suppliers and manufacturers in industrially advanced countries make these markets both expensive and difficult to enter. Whilst the market sizes are large, the rate of market growth, because these countries often have products in the mature stage of the product life-cycle, is usually quite modest.

International business strategies which include these countries call for large amounts of resources, sophisticated marketing programmes and an ability to withstand fierce competitive pressure and powerful buying policies of retailers and other buying organisations.

Newly Industrialised Countries

These are countries of considerable growth potential. Many markets will be in the growth phase of the product life-cycle. The economies of many NICs will show much faster growth than industrially advanced countries and LDCs.

NICs are often difficult to enter because of entry barriers erected by protectionist governments, who wish to nurture their local industries and to protect local employment levels.

Initially, NICs had few indigenous industries, but as the term “NIC” implies, they have developed an industrial capability. This means that local competition for some products will be strong. The local manufacturers – for example, Proton cars in Malaysia and Samsung electronics products in South Korea – have several advantages over international competitors:

- They often benefit from lower costs – resulting from labour and land costs.

- The local suppliers will avoid the tariffs that an international company has to pay.
- The local company may benefit from cultural knowledge.
- As they become more successful, they can benefit from local country of origin effects (see later).

International business strategies aimed at NICs often need to take a long-term view. The market growth is attractive, but the barriers to entry are high. To overcome the financial and cultural barriers, some companies form joint ventures and strategic alliances with NIC companies.

Lesser-Developed Countries

These countries can be very risky – political control in some can be autocratic and economic and financial control might be poor, with some countries such as Brazil suffering from very high (100% or more per annum) inflation rates. The currency of the country might not be easily convertible into the major currencies in the world.

Market sizes in LDCs are often very small because of limited buying power – affecting government and business markets as well as consumer markets. The whole system of distribution channels, the infrastructure of the country and the media are all restricted because of the relative poverty of the country.

International marketing strategies to LDCs have to cope with high levels of risk, a slow and often inefficient bureaucracy, and small market sizes. However, the absence of local manufacturers and the absence of powerful distribution channel members can make these markets important additions to company sales and profits.

Table 7.2 summarises the main factors influencing international business/marketing strategies in the markets of countries at different stages of economic development.

Table 7.2: Influences on business strategy in different types of economy

Main Business/ Marketing Factors	**Type of Economy**		
	Lesser Developed Country	**Newly Industrialised Country**	**Industrially Advanced Country**
Market Size Importance	Small, but in some markets might be important.	Of growing importance.	Very important.
Barriers to Entry	Often high.	Often high.	Formal barriers low, but marketing barriers high.
Level of Country Risk	Very high.	Varies but can be quite low.	Lowest.
Infrastructure of Transport, Power and Communication Systems	Very poor.	Patchy. The fast growth in the economy means that the infrastructure struggles to keep up with the rate of growth.	Very good.
Distribution Channels for Consumer Goods	Very fragmented.	Urban centres similar to advanced countries. Rural areas can be similar to LDCs.	Very competitive. High concentration of power.
Strength of Local Competition	Usually known.	Becoming stronger and stronger in some markets.	Often intense.

F. STRATEGY AND FINANCE

There are three particular financial implications that need to be considered:

- The capital requirements of different strategies.
- The extent to which different international marketing strategies increase or reduce the risks from exposure to variations in foreign exchange rates.
- The need to be paid!

Capital Requirements

There are two aspects of capital requirements:

- Initial capital to start up the strategy

- The working capital that will be required to support the strategy

The initial capital requirements of some strategies are considerable. In particular, market entry strategies to establish a complete production and marketing subsidiary will require large amounts of capital which will be repaid only over a number of years. Strategies that depend upon major co-ordinated product launch programmes in a number of countries at the same time will require initial capital for the large production that will be required.

Working capital requirements will relate to any expansion of the international programme. If extra countries are added, more sales sought in particular countries, more products added to the product mix, etc., extra working capital will be required to support the company in the period between buying the extra raw materials and receiving the payment for the products. You should note that it will be customary, in certain countries, to pay invoices after 60 or 90 days. This slower payment, when compared with the UK's more customary 30 days' credit, means that more working capital is required to tide the company over this one- to two-month delay.

The decision to adopt a key market concentration strategy will have considerable financial implications. The extra marketing research costs incurred in order to understand the market better and the higher costs in the marketing mix programme incurred to increase market penetration to build market share, need cover from a financial point of view. The company might not break even on its key market strategy for several years. Most companies would aim to balance this cost through a balanced portfolio of country markets in which some require cash, this cash being funded by markets in which a strong business position has been built in the past.

Foreign Exchange Risk

This is not, for many companies, a major constraint in the development of international business strategy. However, you should note that foreign exchange rates can often fluctuate to a much greater extent than the profit margin for the product or service. In the short term, companies can buy currency forward. In this way they know exactly what rate of exchange they will receive.

Major MNEs and transnationals will try to reduce the amount of foreign exchange exposure by attempting to balance the need for different currencies through buying materials and components in the same currencies as they receive in sales revenue and in profits. Whilst this will never match completely, the desire to minimise the risk of foreign exchange fluctuations will influence the large major world companies.

In exporting, foreign exchange relates to sales revenue; in entry modes in which the company sets up a production/marketing subsidiary, the risk relates to the ability to repatriate the profits that have been earned. In licensing and franchising arrangements, the returns will be based on the fees and returns agreed in the licensing or franchise agreement.

The Need to be Paid

This is obviously an important item. The functional detail will be handled at a legal and financial level in the company. It is important to take account of the need to be paid. This is partially assessed through country risk indices and relates particularly to major investment decisions. It is usual for companies to seek insurance cover, through schemes like the export credit guarantee arrangements, to protect themselves against default by buyers from other countries.

Study Unit 8

Organisational Structures, Cultures and Capabilities

Contents ***Page***

INTRODUCTION

Planning, it is said, is nothing unless and until it generates action. This statement illustrates the importance of having effective organisational structures, systems and procedures allied to the strategic international business and marketing planning process. In addition, given that plans are implemented through; and by people, the human resource aspects of international strategic planning are also crucial.

The way in which a company organises its activities has a significant influence upon its success. Organisational structures and procedures influences organisational effectiveness and efficiency in a wide variety of ways including, for example, speed of response to market changes, access to and use of resources, communication systems and control and evaluation of plans. In this study unit we will look at different organisational structures and the reasons why some structures will be preferred in certain situations. We shall also be examining the notion of "organisational culture" and its influence upon the international planning process. The effectiveness and the efficiency of the international organisation is influenced by the resources of the organisation. Amongst the most important of these resources is a company's human resources. We shall also be looking, therefore, at the management and control of human resources in international marketing, and in particular some of the issues which arise when choosing between and managing local, expatriate and global staff.

A. ORGANISATIONAL STRUCTURES

The type of organisational structure that is appropriate for an organisation will depend upon many issues. Some issues are fairly obvious. For example, small and medium-sized businesses will have smaller and less complicated organisational structures than very large companies such as Unilever or Procter and Gamble. The number of different country markets and the current size of the company market share in different markets will influence the need for the number and type of people to be employed internationally. The types of product and service and the overall product mix will affect the organisation. For example, a management consultancy firm such as McKinsey and Company will require different types of people from a manufacturing company such as Ford or Electrolux.

Perhaps less obvious as an influence on organisational structure will be the amount of experience that the company has in international markets. New and inexperienced companies in international markets are likely to use different approaches and have different tasks when compared with companies who have been established successfully in the market-place for a number of years. Another important influence on the organisation is the level of challenge of the objectives that have been set by the organisation. If the company is seeking to grow rapidly, it will need a different type of organisation from a company that is attempting to hold a stable position. Another important influence on the international organisation is the extent to which the company is trying to standardise its activities. A company with a policy of running separate country operations will organise itself quite differently from a company with a pan-European or a global standardisation approach.

Horizontal Structures

As in any organisation, the international business must weigh a number of competing bases upon which to divide its operations and decision making.

(a) Centralisation and decentralisation

There are several conflicting pressures as companies expand their business internationally. As the company enters new country markets and expands its product mix, it comes under pressure to decentralise. By allowing more autonomy at the local country level, it can develop and

implement plans that are more appropriate for the specific needs of the customers in that country. As the company allows more decentralised decision-making, it finds that products are extensively adapted or are totally different between one country and another. Company and brand names, trade marks, and advertising campaigns will spread apart. In allowing differences, the company is denying itself the opportunities to make cost-saving economies. It is denied large economies of scale. It is denied some of the benefits of increasing experience, because the experience effect is limited to the country operation. If the company operations were more similar, then the total volume of production and sales would build up and thus allow economies to be achieved.

A different pressure is to centralise. Companies may wish to centralise their key activities in order to co-ordinate and control their international activities. The centralised approach has the benefits of organisational neatness, of standardisation and of the opportunities to profit from scale and experience advantages. More recently, some companies have sought a more centralised approach to allow them to develop an organisational capability to launch products simultaneously in a number of different country markets. Another reason for more centralised control is to mobilise the ability to plan and to implement international competition strategies.

Certain difficulties result from an over-rigid approach to centralisation. The main difficulties are that central headquarters will be too remote, geographically and culturally, to understand the particular requirements of specific country markets. A further difficulty is the "not invented here" syndrome. Managers who are required to manage programmes that have been developed at central headquarters will not feel involved with the plans and will, therefore, not be so highly motivated. The extent to which the objectives of the plans are achieved will be influenced by the enthusiasm and motivation of the people employed at country level. The "not invented here" syndrome, therefore, needs to be taken seriously.

(b) Specialisation

In developing the international organisation, the company will need to take account of specialisation across the dimensions of function, product and geography. In most organisations a balance between the conflicting interests of these three dimensions needs to be reached.

- ***Function*** is concerned with occupational specialisation. Functional specialisation becomes more important with the growth in organisational size and complexity so, for example, the marketing function in a large organisation itself will require functional specialists in marketing management, selling, sales promotion, marketing research and so on.
- ***Product*** is concerned with the co-ordination, integration and control of activities based on the product. This type of specialisation enables the company to deliver high levels of expertise in relation to particular products.
- ***Geography*** is concerned with matching the company with its external environment. In the domestic market, most companies organise their sales force with specialisation based on areas and regions within the country. In international business, it is usual to base some of the organisational structure around countries, trading blocs and world regions. In this way, closeness to customers and an improved knowledge of the factors influencing the market-place are achieved.

Extent of International Involvement and Structure

We have previously identified various stages in the growth of international involvement from an export selling to a global marketing stage. We can build a match between these stages and the type of

organisation appropriate to the approach to international business. This is outlined in the following table:

Stage	Organisation form
Export selling	Ad hoc arrangements
Export business	Export department
International business	International division
Multi-national business	Growing use of groups of countries/continents- based organisations
Global business	Matrix and transnational organisation

As the company expands its international sales and profits, it inevitably finds that ad hoc arrangements are insufficient. The early arrangements are primarily concerned with facilitating the order by arranging the physical despatch of the product, and the necessary financial details of which currency is being specified and how the invoice will be paid. With more orders the company will benefit by developing a specialist department to handle the various demands of exporting. Over time the export department becomes less burdened by the administrative detail of exporting and begins to become more proactive in developing business plans.

Increasing size will cause the company to consider the need to expand the function and status of the export department into a division. Further company expansion in its international business will bring forward the need to co-ordinate activities by parts of the world, for example Asia, and at its ultimate to attempt to develop a transnational organisation.

Examples of international structures are given below:

Figure 8.1: Export department in a functional structure

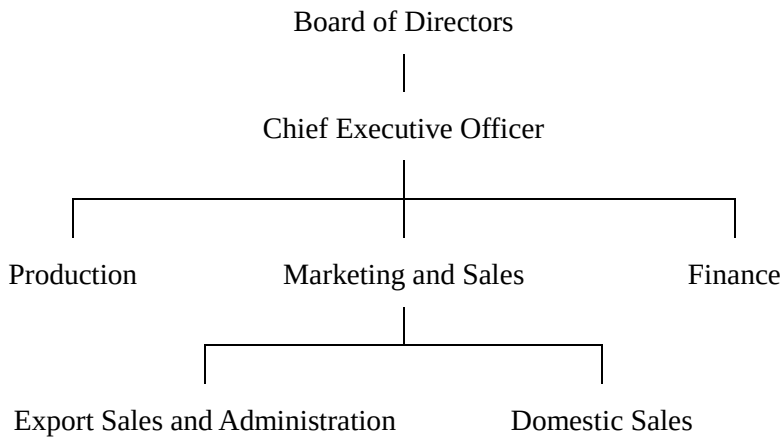
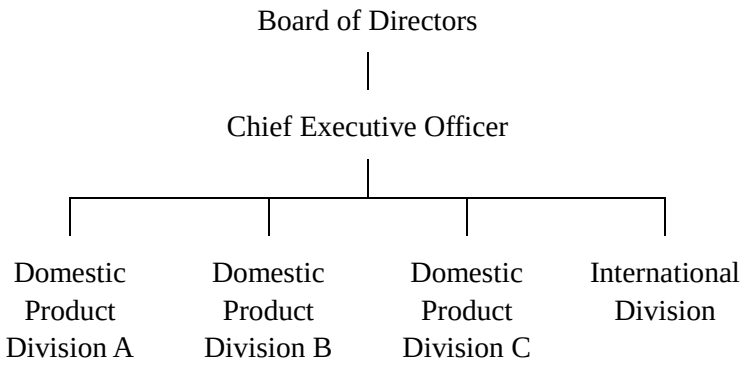


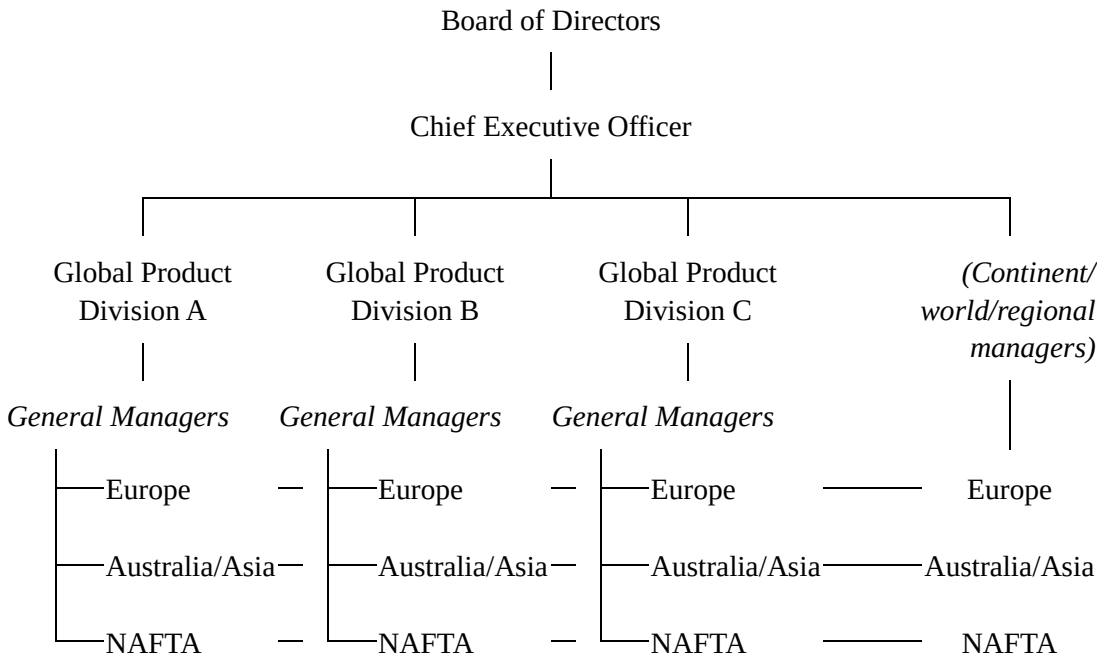
Figure 8.2: International division in a product structure



It is probable that the international division would have specialist geographical regions based on the most important regions for the company.

Figure 8.3: Continent/world region organisation with a functional structure

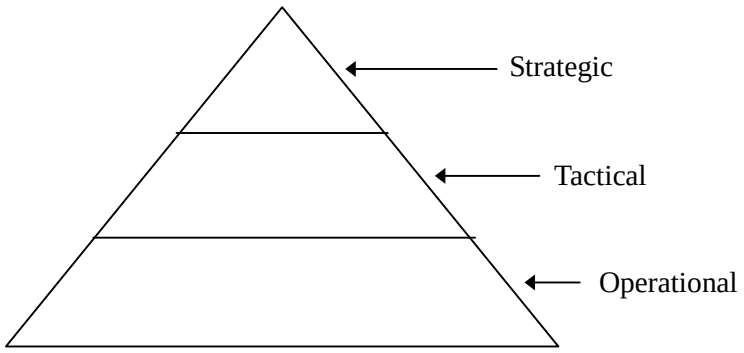
Figure 8.4: Matrix organisational structure - product divisions and world regions



Management Structures and Horizontal Form

The basic management structure in any organisation may be represented by a pyramid as follows:

Figure 8.5: Management levels in a basic pyramid structure



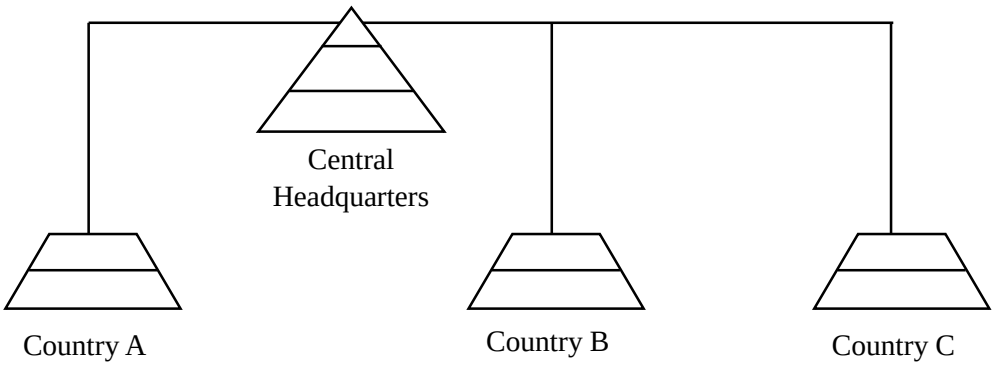
In all organisational structures, it is probable that there will be these three levels of management responsibility. The recent moves by many companies to reduce costs and to improve organisational responsiveness by reducing the number of layers in the organisation would tend to flatten the pyramid, but there will still invariably be a small number of senior managers involved in strategy and a larger number of tactical managers (middle management) concerned with organising and leading lower level operational management (supervisors).

The extent and the importance of these levels of management may vary with different horizontal forms adopted by international businesses. These differences were considered by Majaro who identified three organisational types – the macropyramid, the umbrella and the interglomerate.

(a) The macropyramid organisation

Here, the whole of the strategic function is performed in head office. In these types of organisations the strategic planning is handed down to product, function and geographic managers to plan in detail and then to implement. In Figure 8.6 three country subsidiaries are shown.

Figure 8.6: Macropyramid organisation

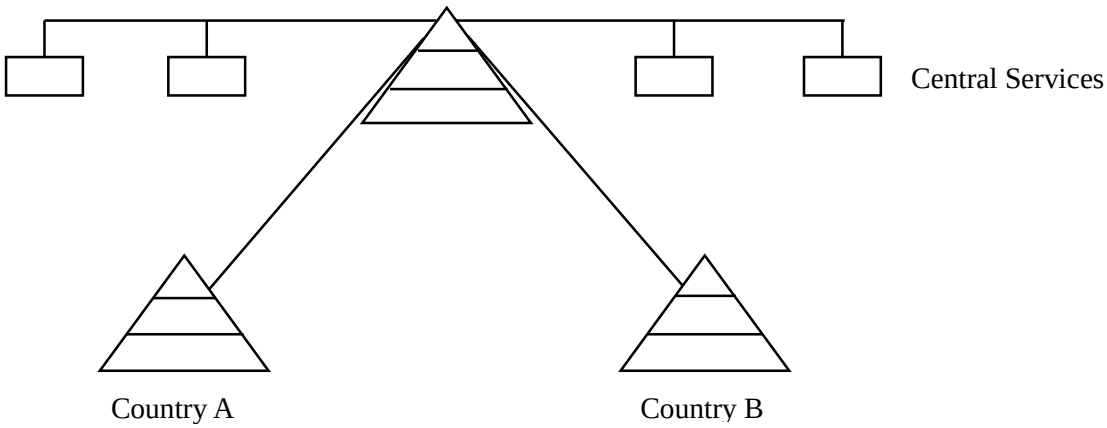


In the macropyramid the main elements of the marketing mix are managed from the main head office. Marketing is standardised as much as possible. Local involvement in the main strategic decision process is limited. Unless the head office is very well briefed about local conditions, its planning may result in missed opportunities at a local level.

(b) The umbrella structure

This is a decentralised system of planning and control. Subsidiaries are given full independence at all three management levels. The centre concentrates on providing very broad corporate objectives and has high level expertise in various functional areas which can be used to provide advice and support to subsidiary companies. The umbrella structure is based on the multi-national enterprise with a polycentric orientation operating in a multi-domestic way.

Figure 8.7: Umbrella structure



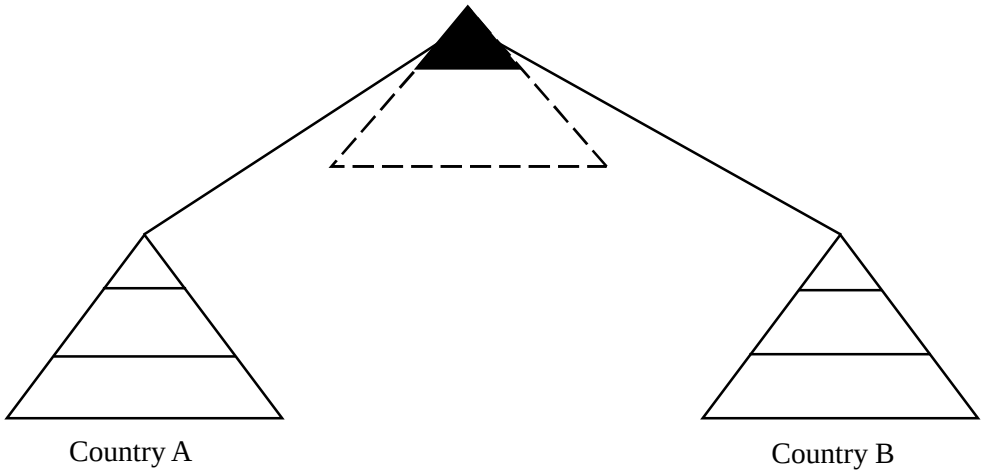
Whilst the umbrella organisational structure encourages local managers to plan for their own market using their specialist local knowledge, it can be wasteful. It can result in many broadly

similar strategies in different countries, yet with fewer of the benefits of shared knowledge or scale economies.

(c) The interglomerate

In this organisation the centre is concerned with financial returns. The strategies to achieve the required returns are the responsibilities of the subsidiaries.

Figure 8.8: Interglomerate organisation



Here, each subsidiary is responsible for its own strategic planning. This type of structure, for example used by Hanson, is most likely to apply to large complex organisations which have subsidiaries in different industries, using different technologies.

Factors Affecting Choice of Organisational Structure

We have already touched on several factors which will affect the choice of the most appropriate type of organisational structure for international business. Summarising these, the following represent the major factors which will affect this choice:

- Company size
- Extent of international market spread
- Range and diversity of products/services
- Level and nature of involvement in international marketing
- Overall corporate and marketing objectives
- Company capabilities and resources
- Organisational culture

Many of these are self-explanatory but the final two on our list of factors affecting organisational structure, namely “organisational culture” and “company capabilities and resources”, need exploring further.

B. ORGANISATIONAL CULTURE

Organisational culture refers to the values, beliefs and attitudes that influence decision-making and behaviour within a company.

We can consider culture in several ways. We have referred to culture in the SLEPT context with regard to customers and potential customers, and to company orientations using the EPRG approach. Orientation is another way of referring to the culture that operates within a company. In addition, we can consider the culture of the individuals that make up the managers and employees of the company.

Here, we shall consider the following aspects of what constitutes organisational culture and review their implications for the international business.

- Country influences
- Company factors
- Management style and structure
- Employee composition

Country Influences

All companies originate from a particular country. For many companies their organisational culture is strongly determined by their country of origin. We have mentioned on a number of occasions how Japanese companies differ in their organisational approach. Japanese society is characterised by politeness and consensus decision-making, therefore organisational culture will be different from the typical US company with its stronger emphasis on directness and individualism.

The strength of the country influence on the company will vary. Companies with a macropyramid structure might be unduly influenced by the location of the central headquarters, which in turn is invariably based in the origins of the company. Atlanta in the United States and Nottingham in England are the central headquarters of Coca-Cola and Boots respectively, because this is where these companies started. As these companies have grown, they have become less and less ethnocentric. Such major companies deliberately strive to change their company culture in order to grow effectively.

Company Factors

Company factors will revolve around the history and age of the company. Companies that are new will have a different set of values from companies that have been established for a long time. The origins of the company in craft practices might influence attitudes in the company long after production techniques have changed.

The type of the EPRG orientation influences the attitudes of people employed within the company. For example, a company with an ethnocentric orientation may find it difficult to develop international markets, because the company is centred on the home market – production might find it difficult to spare the time in the production schedule to produce “a strange foreign order”; the advertising manager might be more interested in the home market. On the other hand, a polycentric orientation will limit standardisation and co-operation, and regiocentric will concentrate on one part of the world to the exclusion of other opportunities. Geocentric culture will be much more expansionist – although it might, however, result in lost opportunities at the country level.

Management Style and Structure

The values of managers are influential in shaping the culture of the company. Companies can evolve into recruiting a certain type of manager to perpetuate the existing management style. Different types of management style are related to those managers who seek to defend the existing business, those that are more entrepreneurial by constantly looking for new market opportunities, and those managers who look for more careful growth through the rigorous analysis of market opportunity.

In considering management style, we find that some management styles might be culturally related. For example, Chinese managers might be very hard-working and inclined to consider higher risk markets and product developments. UK managers have sometimes been criticised for failing to take risks. They have tended to avoid commercialising the apparent opportunities that have developed out of research and development programmes.

Management structure can also influence the culture of the company. The three styles implicit in the macropyramid, the umbrella and the interglomerate, illustrate that controls will be exercised very tightly in some companies and much more loosely in others. The macropyramid style will be more enveloping than the umbrella style. The umbrella style will give subsidiaries considerable autonomy, provided that they achieve the agreed objectives. In one sense the interglomerate will be even looser. However, the financial controls set are usually based on challenging financial objectives. The controls are fewer but the fear engendered in failing to achieve the financial objectives can substantially invade the culture of the company.

Employee Composition

Most companies start by employing people from within their own culture and/or nation state. In some countries this will mean the same thing – for example, most people in Japan are Japanese and therefore Japanese companies located in Japan will employ Japanese people. A company in the US, though, whilst employing US citizens, might employ people from a wide range of cultural influences – some employees might be of Italian, Irish, Dutch, Puerto Rican or Mexican origin. The degree of international spread incorporated within the company will initially, therefore, depend considerably on the country and the employment policies of the company.

Growth in the company and in its involvement in international markets will result in the employment of more and more people from different cultures and different countries. The company can seek to develop a more international organisation by recruiting, training and developing, and promoting people of different nationalities to achieve a team of multi-cultural international managers.

The company can make choices about the use of expatriates to staff its international operations. The extensive use of expatriate managers on short to medium assignments of six months to three years will provide expertise and consistency to the remoter parts of the organisation. However, the damage caused is in the slowing down of a more international organisation. It is the transnational organisation that will be particularly anxious to develop a team of very experienced and culturally sensitive international managers. Ohmae refers to the need to develop “equidistant” managers in the true global business. Such managers develop and respond to the most important strategic issues wherever they arise around the globe. This contrasts with the typical manager who tends to be most influenced by home-country events.

The international company could use expatriates, nationals or global managers. For many companies, expatriates have been used whilst the managers taken on at national level are developed to reach the company standard. Once the national managers have shown their ability to perform, expatriate managers are used less and less frequently. The more successful national managers will be promoted into international positions.

The global manager, with equidistant cultural abilities, is quite rare. It is arguable whether there are companies that are operating on a truly global basis. However, it is certainly true that there is a shortage of international managers with a high level of country-specific knowledge across many countries and a cultural awareness that enables them to analyse, develop and implement successful strategies.

We shall discuss the issue of deciding between using expatriates, nationals or global managers in more detail in the next section, together with the related issue of whether to use in-house or external resources.

C. STAFFING AND THE INTERNATIONAL BUSINESS

As companies grow and become more dependent upon international business to contribute to their total sales revenue and profits, they will employ more and more people internationally. The ways in which staff are deployed is of great importance and we shall examine three aspects of this in this section.

- The capability of an organisation to manage its tasks effectively is both an in-house and an external resources decision. Whilst lower cost is an important factor in the decision to use external resources, there are important cultural benefits to be gained from using locally based agencies and consultancies.
- Expatriates have been used by many multinational organisations to inject unavailable local expertise. They have also been used to provide "glue" for the organisation. The movement of expatriates from corporate headquarters to subsidiaries around the world provides the means to diffuse the culture of the company.
- Whilst expatriates can help the control and co-ordination of the company, they can block the development of local managers. A challenge facing management in the future is how to develop local management and to develop multicultural management teams. These times will be based on talent rather than on headquarters country citizenship. For the world's largest companies the equidistant manager will be the very difficult goal.

In-House and External Resources

The general trend in many businesses is use direct employment of people within the organisation to concentrate on the main activities of the business. For activities that are undertaken less frequently or are less central to the company, the organisation will buy-in agencies, consultancies and people on short-term contracts – it will use external resources.

For example, in the marketing area, many functions can be bought-in from outside. It is common to use advertising agencies – their use being based primarily on the cost-saving advantages derived through the commission system. In areas such as logistics, the use of external resources will be justified partly through cost savings and partly through the need to buy-in specialist expertise that is not available in-house – for example, freight forwarders can use their considerable knowledge of freight handling and international transport systems to make cost-saving, efficient decisions. The infrequent exporter, on the other hand, will lack information about the best possible routes and price deals available. Because of a lack of consistent throughput of export orders, the infrequent exporter will not need to employ people on a full-time basis. This then becomes a vicious circle because without full-time specialist people working in-house, the company will not develop experience of the rapidly changing world of international logistics.

In Table 8.1 we set out some of the possibilities of employing external resources in respect of the marketing mix.

Table 8.1: Use of in-house and external resources in marketing

Marketing Mix Factor	**In-House Resources**	**External Resources**
Product	Because of the central position of products to the organisation, product management is usually handled in-house.	Some new product development specialist expertise might be used.
Price	Handled in-house.	Services for technical details of documentation and foreign currency exchange which influence the final price are often bought-in.
Distribution-Channels	Some distribution methods will be handled by the company.	Smaller companies often use distribution channel intermediaries such as agents and distributors.
Distribution-Logistics	Some distribution methods will be handled by the company.	Many companies use external transport companies for sea or air freight.
	Large companies often use in-house expertise for export documentation.	Smaller companies may use freight forwarders or transport companies to handle export documentation.
		Most companies use banks to help finance international orders and to arrange foreign exchange.
Promotion	Selling is usually handled in-house. Face-to-face selling in external country markets may be carried out in-house (especially through the use of subsidiaries).	Advertising, public relations, sales promotion and design are usually bought-in from outside specialist companies.
		Selling activities by agents and distributors will be part of the selling/distribution channel interface.
Marketing Research	Large companies will have in-house MR specialists, but will usually buy-in MR as well.	Smaller companies often rely on Government-sponsored marketing research schemes.
International Marketing Planning	Most companies will regard this as an in-house activity but will sometimes employ consultants to give an external perspective.	

The overall position is that it is unlikely that a company will possess, in-house, all the knowledge and specialist expertise that is necessary in international business. It will, therefore, be necessary to buy-in external resources. The balance between in-house and external resources will vary considerably from company to company. Some companies will have a policy of handling most activities in-house. This is likely to be the case if confidential information is an important part of company success. If the knowledge required for the product or service is very specialised, this will limit the chances of finding suitable outside people with the appropriate levels of knowledge.

The main reasons for using outside specialists are:

- Outside specialists may have more specialist knowledgeable than in-house personnel – for example, in foreign exchange dealing or in handling marketing research surveys across a number of countries with widely different cultural behaviour.
- It is cheaper to use outside specialists – this is likely to be the case if the amount of work in-house is insufficient to justify full-time direct employment.
- To manage a temporary need for extra people to handle a particular issue – for example, the need for interpreters for the duration of an international trade fair.
- Outside specialists have the appropriate language and cultural fluency for particular markets.

In addition to these four factors, companies will, sometimes, need to undertake a "step-change" in their approach to international business. For example, a large multinational company may wish to develop a more global approach. If this is the case, specialists will be useful to help define appropriate strategic directions and to devise ways in which the corporate culture can be changed to a more geocentric orientation.

The Expatriate and the National Manager

In this section we will look at the reasons for using company personnel working in their own country and compare these with the reasons for using company personnel, but basing them in another country. Company personnel based in a different country are often referred to as "expatriates". Expatriates may exist at any level or functional specialism within the company, but the main area of concern is at management level.

(a) Strategies for using expatriate and local managers

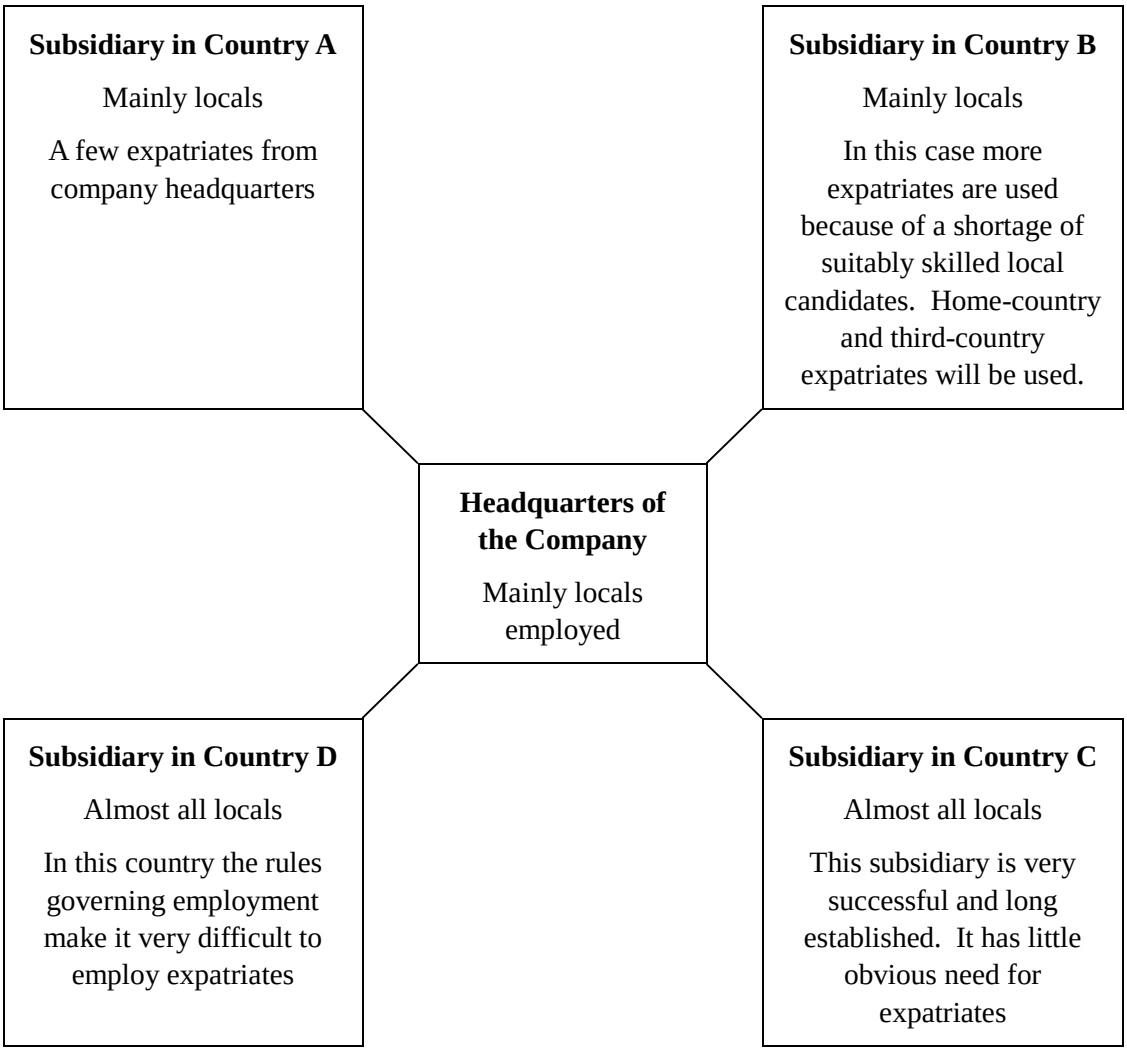
The main types of manager employed by international companies can be classified as follows:

- ***Locals* –** managers who are citizens of the countries in which they are working.
- ***Home-country expatriates* –** managers who are citizens of the country in which company headquarters are based.
- ***Third-country expatriates* –** managers who are citizens of a different country from the company headquarters and the country where they are working.

We could posit that most companies will want to use local managers to fill the positions in both the company headquarters and the company's various subsidiaries around the world. Thus, the typical company would have something of an ethnocentric bias in its headquarters and polycentric influences in its subsidiaries, because of the proportions of nationalities and cultures that it employs in its various countries of operation.

However, the position is likely to be more complicated depending on a number of different factors. Figure 8.9 sets out some of the strategies applicable in varying conditions.

Figure 8.9: Different strategies for employing local and expatriate managers



The position illustrated for Subsidiary A shows how companies will usually wish to use a number of expatriates in their subsidiaries to control the organisation and to ensure compatibility in the way in which systems are developed and implemented. Subsidiary B shows an example of situations in which a large number of expatriates might be needed – for example, if there are few local marketing specialists in a company, expatriates will be needed to fill the gap. Subsidiary C illustrates the situation found when a subsidiary "earns" a high degree of independence from company headquarters because of its consistent ability to meet its objectives. The example of Subsidiary D is one in which the company may wish to employ expatriates, but is prevented from doing so by rules, regulations and laws established by the country concerned. Many countries in Africa have considerably restricted the numbers of expatriates that multi-national companies can employ.

(b) Why use expatriates?

The main reasons why companies use expatriates can be summarised as follows:

- To provide immediate technical competence – expatriates often have the required knowledge and skills (for example, in the use of marketing research) which do not exist in the local workforce.

- To facilitate co-ordination and control between the subsidiary and the complete organisation – expatriates' familiarity with communications and the culture of the company provides a basis for developing similar systems and culture in the subsidiary.
- To enhance the (expatriate) manager's development in the international arena.

There are problems with using expatriates, however. For many people the difficulties caused by geographic mobility are too great – the move affects not only the manager, but the manager's family. There are also difficulties in career progression at the conclusion of the expatriate assignment. If the company does not manage the return of expatriates so that managers are able to enhance their career prospects, they will resist attempts at expatriate assignments.

Cost is another important factor. The relocation costs, housing and costs such as the education of the children from expatriate families, are often surprisingly high. In addition, costs of living in other countries, particularly major cities, can be higher than the expatriate's domestic residence. In a survey of the cost of living in the world's biggest cities by the Economist Intelligence Unit, Tokyo was by far the most expensive city. Using New York as the base, rated at 100, Tokyo was just over 200. The next city was Zurich at 125; Paris, Seoul, Hong Kong, Moscow, Singapore, Frankfurt and London ranged between 125 and 100 in descending order. Bombay and Belgrade at about 50 represented the cities surveyed with the lowest living costs.

A further problem with the use of expatriates is the way in which it can inhibit the development of local managers. If all senior appointments are made to expatriates, not only does this prevent local managers from developing the experience necessary to operate at higher levels in the international organisation, but it is also a serious demotivating force discouraging people with the potential to be high flyers. Their reaction might well be to seek employment in other organisations in which their talents will be more aptly rewarded.

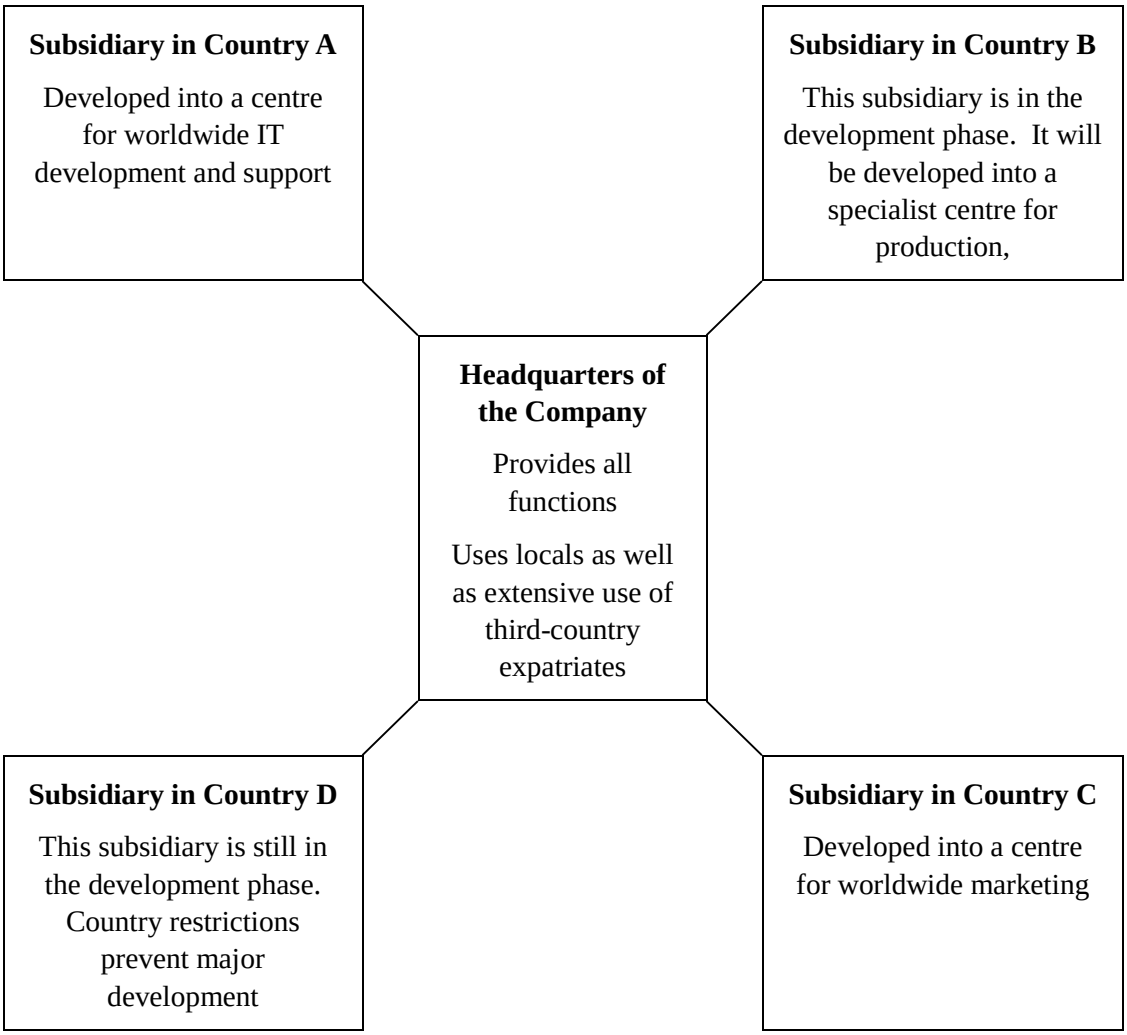
The Development of a More Global Approach

Figure 8.9 represents the type of approach taken by many multinational enterprises in the past. However, companies are now developing ways in which they can be more flexible and more attuned to the cultural requirements of the market-place. One way in which this flexibility is being sought is through approaches being propounded by gurus such as Tom Peters. They propose breaking down typical organisational hierarchies to enable companies to be "disorganised", to allow them to cope with the disorganisation and change they face in their environment and in their markets. The other main development is the "borderless world" view of Kenichi Ohmae and the need to build management teams and managers to cope with the new complexity of international marketing. One strong view propounded by Ohmae is the need to develop equidistant managers. Equidistant managers would have the knowledge, experience and cultural flexibility to operate on a global basis without their decisions being flawed through self-reference criteria. This is obviously very difficult to achieve.

(a) Developing specialist centres

Figure 8.10 represents a more global company. This company still has the major headquarters based in the country in which the company was originally founded. However, the company aims to use specialist centres based in different parts of the world and uses managers more on the basis of merit than the fact that they are nationals of the company headquarters.

Figure 8.10: Strategies for building the global company



In all subsidiaries, except the restricted case of Subsidiary D, the company employs a number of home-country and third-country expatriates. It aims to develop managers from each subsidiary, some of whom will be moved to company headquarters, others to other subsidiaries.

(b) Developing the international manager

The important issues in the development of the international manager centre around building personal competence in respect of management and business skills in general, and in the particular requirements of the international arena, including developing cultural flexibility and language skills.

Companies will face the process of management development in a number of ways, but the main aspects will centre around planned experience and training programmes.

- ***Developing experience***

  Experience needs to be developed in a progressive way. Managers will be exposed to jobs in various countries with progressive difficulty, success at one level being the normal prerequisite for progression to the next level. Experience needs to be developed in various countries. Each country will pose different cultural challenges. In particular, it will be the ability to apply management solutions successfully in different countries

that will be crucial. Progression beyond the country management level to the grouping of countries level needs to take place.

- ***Training and development***

  In most instances, managers will be given in-house training and training from external providers. This training will be used to develop managers' general and international management expertise. In addition to specific management courses, though, the manager should attend courses for cultural preparation and inter-cultural analysis and to improve language skills. For managers operating in many different countries, it will be impossible to learn every language to a high level, such as is required for negotiating or presentation purposes. However, he/she should possess high-level language skills in at least one other language and social survival language skills in all the important languages that relate to his or her geographic responsibilities.

(c) The concept of the equidistant manager

In the major companies of the world, the imperative of global management is strong. These companies market and compete in global markets. In order to do this, they need to develop managers who avoid continual reference to constricting experience and values. Kenichi Ohmae's concept of the equidistant manager provides the basis of this.

The equidistant manager develops strategy and implements plans based on the importance of the customer or market, not on geographic proximity or home-country cultural terms. He/she avoids:

- A vision dominated by home-country customers.
- A vision dominated by specific company subsidiaries.
- A view that everything outside the company and the country is part of "the rest of the world".
- The words "overseas", "subsidiaries" and "affiliates" because these serve to separate the home domestic operation from the rest of the world.

The whole process is, of course, very difficult. The main issue for those businesses who need to operate globally is that they ***must*** develop values and attitudes amongst their managers that are global.

In the UK we are regarded as part of Europe. Some people in the UK regard the UK as an essential component of Europe. They regard the integration of the UK into Europe as crucial for the future prosperity of the UK. Others in the UK wish to retain a traditional country independence. From the more limited perspective of the UK and Europe we can see how difficult it is to develop a reliable, equidistant view within Europe. When this is attempted on a global scale, the whole process is exceedingly difficult.

The equidistant manager will need a strong educational foundation. This foundation must incorporate a fluency in several languages and an understanding of culture through immersion in the culture and the language. The company will need to use selective international experience and training courses, within a company that is developing an equidistant culture, to build on the educational foundation. Of course, in addition to this, the manager must be capable and successful in international management and business.

Study Unit 9

International Strategy: Standardisation, Adaptation and Globalisation

Contents ***Page***

INTRODUCTION

In this study unit we examine in detail the significant issue of standardisation and adaptation as a strategy in international business.

Standardisation refers to the approach taken in which the marketing mix is used in the same way in different countries. There is an important distinction to be made between the same and similar. It is unusual for ***exactly*** the same marketing mix elements to be used in different countries. It is more frequently the case that the intention is to introduce the same approach but that minor changes are required for different markets. We will regard this as standardisation. Adaptation relates to the approach in which the marketing mix is deliberately changed so that it relates to each market.

After looking at standardisation and adaptation, we will move on to examine the issue of globalisation as a strategy. In itself globalisation could be regarded as an extreme form of standardisation. As you will see, although globalisation does involve some standardisation, it does not depend upon it.

A. STANDARDISATION

The ability of companies to develop standardised approaches across each of the elements of the marketing mix is a major debate in international business strategy.

Approaches to Standardisation

It is possible to view standardisation both as a process and in terms of implementation.

(a) Process standardisation

Because a company can control the processes it uses, this is an easier form of standardisation than implementation. A company can establish the particular planning methods that it thinks appropriate. In this way, analytical methods, planning and international strategy can be controlled substantially within the company and it can insist that the same approaches are taken by subsidiaries in different parts of the world.

- ***Analysis*** can be similar, based on policy decisions to use the same marketing research methods and surveys. Information can be collected, stored and disseminated in the same ways using a common information system.
- ***International strategies*** can be developed from the same analytical methods using a standard format of marketing models and techniques.
- ***Marketing planning*** can be based on similar lines in the company headquarters and in country subsidiaries.
- The ***marketing mix*** elements can be developed along standard planning approaches. For example, the company could use the same planning methods for advertising decisions.

(b) Implementation standardisation

It is much harder to standardise implementation than the processes of international marketing. The reason for this is that the implementation involves direct contact with customers, potential customers, distribution channel members and others. Direct contact will be influenced by the market structure and behaviour in the market. For example, in some markets there may be strong competitors with aggressive marketing programmes designed to increase market share, whereas in other markets, competition might be much less aggressive. Another direct contact issue is the need to take account of the culture of the country market.

Thus, we can see that, when a company attempts to implement its chosen strategies, it may find that its various customers do not all react in the same ways. The company has little or no control at the implementation level and it is more likely, therefore, that the company will have to change parts of its marketing mix in order to satisfy customers.

- ***Product***

  This is a part of the marketing mix that many companies aim to standardise. The augmented view of the product includes the physical product plus the brand and company name and trademarks. It includes the packaging, warranties and guarantees. It is possible, therefore, to standardise part of the product and adapt other elements. Some companies will have the same physical product but may change the packaging and the labelling. Language change is an obvious adaptation.

- ***Price***

  It is very difficult to standardise price because it is influenced by so many country factors. There are many differences in the tariff rates charged for imports, value added tax rates, distribution channel margins and the prices set by the main competitors. In addition, there are considerable differences in the ability of consumers to pay a particular price level. Whilst a company can have a policy to charge good value prices in the middle of the market and, therefore, have a standardised process approach, the practical implementation will give rise to many detailed adaptations.

- ***Promotion***

  The selling part of promotion is usually adapted. The reason for this is the interface between the salesforce and the country distribution channel. Because distribution channel members are strongly influenced by the culture in the country, the salesforce - if it is to be successful - has to adapt to local requirements.

  Public relations and sales promotions are also often adapted to fit local requirements. It is the advertising decision that stands the best chance of standardisation. This is because it uses media that are less culturally specific than the other elements in the marketing mix. It can also standardise the advertising message if customers have similar buying motivations and if they seek similar benefits.

- ***Place (Distribution)***

  This is a marketing mix element that is strongly influenced by market and country forces. It is difficult to standardise the implementation of distribution.

In the case of service products of course, the traditional 4Ps of the marketing mix can be extended as follows.

- ***People***

  Perhaps as one might expect, this is one of the most difficult elements of the services marketing mix to standardise. By definition, people are individuals and in addition, of course, people differ between different cultures. Standardisation can be achieved to some extent, however, through careful training and staff development.

- ***Process***

  As you are aware, the process element of the services marketing mix relates to things such as how the service is delivered, ordering systems and so on. Compared to the people element, process is generally much easier to standardise – so, for example,

McDonald's processes for taking orders, cooking these orders and treating customers in their outlets are very highly standardised throughout the world.

- ***Physical Evidence***

  Like process, this element of the services marketing mix, too, can be standardised to a high degree. Again we can use the example of McDonalds where the layout and décor is more or less standardised throughout the world. Standardising physical evidence is particularly important in trying to develop a uniform company image, and is often a key part of franchise services marketing.

You should note that we shall be considering each of these elements of the marketing mix, including the issue of standardisation versus adaptation, in more detail in later study units of the course.

The Arguments for Standardisation

The main arguments for standardisation are based on two areas – cost and customers.

(a) Cost

A strong argument for standardisation is presented by the general and financial management of companies. It can be demonstrated that the elimination of variety and the constant repetition of company activities around the same products will give economies of scale and experience benefits. Economies of scale relate particularly to manufacturing, whereas the experiences effect can be gained in any part of the organisation through the efficiency gains resulting from familiarity.

Within the marketing mix the main areas of saving will be based on the high cost areas. The highest costs, for most companies, will be in the product area. Most companies will attempt to reduce the amount of variety in the products that they produce. They will prefer to produce one product which can be sold in all markets. Unfortunately, this ideal state is rarely found.

The other main area in which companies seek to standardise is the marketing communications (promotion) area. Companies that have large budgets for media advertising can often make substantial savings by using the same advertisements in a number of different country markets.

(b) Customers

When customers are mobile between one country and another, as for example in the purchase of film for cameras, there are benefits in selling the same product and promoting it in the same way. If the product and the way it is presented change, customers can become confused and end up buying a different product. For the customer, a strong consistent brand image that does not exhibit variations in different countries will be reassuring.

Even in markets in which customers are not internationally mobile, there can be customer benefits in a standardised approach. If the same customer segments are found across country boundaries, it makes sense to use similar products and advertising. Whilst the benefits in this instance relate to cost savings, there is the marketing logic of developing a marketing mix that is based on customers. If the customers are the same, in terms of the benefits that they seek, why not make the marketing mix the same?

In many companies the cost-saving argument will be stronger than customer similarity – it is easy to demonstrate cost savings and harder to show customer similarity. However, it is important for companies to be responsive to customer requirements. It is quite possible that cost savings through standardisation will be pursued too vigorously and ultimately to the

dissatisfaction of the customer. Customer satisfaction, though, can be achieved at the same time as benefiting from standardisation based on customer similarity. The important proviso is that similar customer benefits have been identified in different countries.

B. ADAPTATION

The reasons for adaptation lie in specific attempts to develop an appropriate marketing mix to satisfy a specific customer group.

The type of company culture or orientation can have a strong influence on the extent to which changes are made. In a company with a polycentric orientation, adaptation is the likely consequence. As each subsidiary becomes more and more familiar with its host country market, it becomes more and more aware of the differences that exist between that country's requirements and the head office view of what it should be doing. This leads inevitably to a situation in which the subsidiary aims to customise its marketing mix more precisely.

The ways in which this customisation will take place will be influenced by the overall company policies and the strength and independence of the subsidiary. If the subsidiary is a major contributor to sales and profits, and if the subsidiary regularly meets its corporate and marketing targets, it will be granted more independence than a subsidiary with inexperienced and unproven management.

Approaches to Adaptation

In a consideration of the marketing mix and the ways in which adaptation takes place, it is clear that most companies will concentrate attempts to standardise on products and on marketing communications. Price and distribution are influenced by so many local factors that very precise standardisation is impossible. Some companies will use a standard price list and some will use a standard distribution channel approach, but these are the exceptions.

For service products, as we have seen, it is process and physical evidence elements of the mix which are likely to be standardised, especially where the operation is a franchise operation. For the reasons stated earlier, the people element of the services marketing mix can be much more difficult to standardise.

The main areas, therefore, in which the standardisation/adaptation argument will take place will be products, marketing communications, physical evidence and process.

For many companies it will be easier to adapt marketing communication than products. It will be usual for the company to have a salesforce that is adapted to local customers and to their requirements. Many companies use sales promotions in a tactical way that relates very closely to the market and the competitive situation that exists in the country. Furthermore, public relations is frequently developed around a knowledge of local media and journalists, and is often, in addition, based on events and activities that are country-specific. For example, in the UK with its intense liking for animals as pets, PR events can be based on dogs and cats; that would be unworkable in many other countries.

Advertising, particularly if it is dependent upon the TV medium, is likely to be the exception to the obvious need to standardise. The high cost of developing a TV commercial is one factor that encourages its use across many countries. A further factor is the difficulty in finding an advertising approach with a strong, positive, demonstrable effect. If the company develops a very good TV commercial, there will be strong pressure on company subsidiaries to use that TV commercial.

Table 9.1 summarises the position with regard to marketing communications in multinational companies.

Table 9.1: Standardisation and adaptation in marketing communications

Activity	Standardisation or Adaptation
Selling	It is very difficult to standardise the implementation of selling. The interface with customers and the distribution channel makes adaptation highly likely.
Sales promotion	Many approaches are tactical and, therefore, will be adapted. Some companies, especially major companies like Coca-Cola, Kodak and Sony, sponsor major world sports events (such as the Olympic Games and World Cup Football) and develop themed sales promotions which can be standardised and used in many different countries.
Public Relations	Most events, media, journalists and political lobbying will be at a local or country level. It is possible to develop a standardised approach across countries, but it is not easy.
Advertising	Lower-cost approaches, for example through the press and posters, will usually be adapted to local requirements. Higher-cost TV advertising, particularly if high-cost, specialised TV commercials are important (as, for example, used by Levis and Coca-Cola), will tend towards standardisation in attempts to cut the costs of producing many different and expensive TV commercials.

Imposed Adaptation

Adaptation is not necessarily the outcome of a conscious decision by a company to change its marketing mix to meet the needs of its customers in a particular country. A whole series of rules, regulations and laws may also be imposed on companies requiring them to adapt the marketing mix that has been developed in other countries, usually the company headquarters country. Examples of such forced changes are given in Table 9.2.

Table 9.2: Causes of imposed adaptations

Marketing Mix Element	Cause of Imposed Change
Product	Safety standards legislation Technical standards Product liability laws
Price	Laws on prices Different tax levels
Distribution	Restrictions on the types of retail outlet, the types of product they can stock
Promotion	Laws on which sales promotions can be used in a country Legal and voluntary controls on advertising content Controls on the amount of advertising that the media can carry (which is particularly the case for TV and radio).
People	Employment legislation
Physical evidence	Local planning regulations
Process	Health and safety regulations

If we take the example of a car, we can see a number of imposed changes necessary in different markets. The product will need to meet the safety standards required in different countries – resulting in changes to seat-belt fittings, external and internal surfaces to reduce injury on impact, the type of braking system, the strength of the body cage, etc. The product will also need to be adapted for left-hand drive or right-hand drive. Other changes will be "imposed" by local climatic and driving conditions – for example, in hot countries air-conditioning might be an almost standard part of the car.

Other adaptations to the same product may not be imposed, but will be influenced by market demand. These will be used to enhance the car's appeal in a specific market – through such adaptations as colour schemes, different levels of instrumentation fitted as standard or different warranty arrangements (in one country the warranty might be for one year, whereas in another, because of competitive factors, it could be as long as three or five years).

C. GLOBALISATION

Globalisation is a particular form of standardisation, perhaps even being seen as its ultimate form.

The increasing convergence of customer demand for some products and services enables those products and services to be thought of as serving a world market. For example, a worldwide market exists for fuel for cars and lorries, for film for cameras and for many consumer durable products. The demand for music and film entertainment services is a very wide one across country boundaries.

With a market demand existing across many countries, and as communications and transport systems in the world improve, it is not surprising that some companies have sought to co-ordinate their marketing approaches. Companies have grown larger and have resources that enable them to take a wider and wider view of world opportunity.

Approaches to Globalisation

The types of co-ordinated approach are obviously related to standardisation as we discussed previously. We can see globalisation in the following ways:

(a) Globalisation as a process

In this way companies can view the world market as a total opportunity. They can develop analyses, plans, international strategies and marketing mixes using a standardised format. Some companies will also develop a standardised approach to competitive strategy that can be co-ordinated across the world – defending in some country markets and being aggressive in others.

Using the process approach, companies can develop a completely similar marketing mix across the world, or they can develop one that has major elements of standardisation, or one that shows considerable degrees of adaptation. This is shown in Table 9.3.

Table 9.3: Global process standardisation

Type	Comments
Completely similar	The world standard brand – this hardly exists in its absolute form. Even Coca-Cola and McDonald's make some minor adaptations in various countries.
Major elements of standardisation	This will reflect some significant customer differences in parts of the world. Companies might take a different approach in, say, Asia and in Europe.
Major adaptation	This is most likely to occur in markets that are culturally highly sensitive. Food products often, but not always, fit into this category.

(b) Global implementation standardisation

At the implementation level, standardisation is possible in certain parts of the marketing mix, but other parts will continue to demand adaptation to the particulars of different country markets.

Table 9.4 summarises the different approaches.

Table 9.4: Global Implementation Standardisation

Type	Comments
Completely similar	This does not exist. There are always local and country and trading bloc differences that cause some adaptation, even if it is quite minor.
Major elements of standardisation	Standardisation might be groupings of countries, or by standardising the product and perhaps the advertising and then adapting the other elements.
Major adaptation	This approach will benefit from the process standardisation, but at the implementation level will look as though everything is totally different. Companies like Nestlé will benefit from similar planning and strategy and control processes, but will exploit market differences to the full by using a highly adapted marketing mix.

Influences on Globalisation

There is no doubt that the trend towards globalisation has been one of the most significant developments in international business during the last decade. More and more companies have become, and many more would like to become, global in their operations. What then are some of the factors which have served to drive this growth and spread of globalisation? Some of the more important factors include the following:

(a) Deregulation of trade/Open markets

We have seen earlier how increasingly world trade has become deregulated. As a result, more and more markets have opened up to the aspiring global business. Even markets which have traditionally been very difficult to move into, such as China and some of the former Communist Eastern Bloc countries, are now open. Japan, at one time highly protected against foreign companies, has opened up in recent years.

(b) Global competition

Partly as a result of freer world trade, we have seen the growth of global competitors. Even companies that have traditionally been very insular in their outlook and approach to business and marketing have woken up to the recognition that increasingly their competitors operate in global markets. One approach to dealing with local competition is for companies to go global themselves.

(c) Risk spreading

We have seen that the global business environment is much more dynamic and complex. In particular, financial and other global trading systems mean that markets can change overnight. For example, recently the Asian economies, from being strong growth economies, almost overnight began to experience major problems with falling share prices, company bankruptcies and so on. So sudden were these changes that some authors have referred to it as the “Asian meltdown”. A company can hedge against the risks caused by such market and economic fluctuations by operating in several markets/parts of the world. Global operations enables the business to spread the risks of sudden downturns and changes in economies and markets.

(d) Economies of scale/Experience curve effects

Usually, global business involves increases in the scale of operations of an organisation. As such, it enables a company to achieve potentially large economies of scale and/or experience curve effects which would be restricted if only domestic markets or relatively few overseas markets were targeted. We saw in an earlier study unit that new product development and the associated research and development costs for many products these days are substantial. Very often these substantial costs can only be recouped if the resulting products are marketed on a global basis.

(e) Supply chain management

A further impetus to developing global strategies by organisations has been the desire to manage the supply chain more effectively – so, for example, some companies have been prompted to go global in order to secure access to low-cost labour or raw material supplies. Sometimes companies are prompted to go global in order to gain access to skills which are simply not available in domestic markets, such as research and development skills, design skills, manufacturing skills, etc.

(f) Global enabling technologies and skills

These perhaps facilitate the growth of global business and strategies rather than prompt it. Increasingly, global business strategies may be developed through access to new technologies and skills. So, for example, developments in information technology and databases facilitate the growth of global strategies and positions. These databases enable the construction of detailed customer profiles across the globe by cross-matching this intelligence to other databases, such as economic data, socio-economic groupings, geodemographic data and so on. The business can identify global segments and their characteristics.

(g) The "global village"

None of the above factors would be sufficient to encourage and facilitate the growth of global marketing if customers were not receptive to global strategies and companies. We have seen earlier, however, that the growth of international business itself has in large measure been due to changing customer needs and wants, and in particular an increased receptiveness and desire for global products and services. We have only to turn on the television to see how the world has shrunk, a phenomenon that many refer to as the global village. So, for example, a news report covering the refugees in Kosovo recently showed refugees wearing Nike caps, watching Sony TVs in their tents and smoking Marlboro cigarettes.

These, then, are some of the key factors which have helped drive the growth of global business and marketing strategies. You must always be aware, however, of some of the key factors tending to inhibit this growth or at least which are considerations before decisions about commitments to a global strategy are made.

(a) Cultural factors

Clearly, one of the major factors limiting the growth of global business and particularly standardised global strategies is differences in culture. Although we have mentioned the growth of the global village, cultural differences still exist in different parts of the world with these differences often being substantial. Businesses cannot simply override these cultural differences, and certainly ignores them at their peril.

(b) Customer tastes and needs

Related to, and often underpinned by, cultural factors, the growth of global business is restricted by differences in customers' tastes and needs in different parts of the world.

(c) Other environmental factors

Finally, a global approach is restricted where there are differences in some of the key environmental forces and factors which we have already discussed. So, for example, legal political and regulatory forces must be considered.

The Range of Globalisation Strategies

At first sight, the choice of strategies with regard to approaches to global markets would seem to be a choice between the two alternative strategies of standardisation or adaptation for both process and implementation aspects of marketing. However, we can distinguish between three alternative strategies with respect to globalisation as follows:

(a) Global strategy

A truly global strategy is characterised by an attitude and an approach to planning in an organisation where no distinction is made between domestic and foreign markets. Plans are developed on a global basis and the only consideration in considering each market is the extent to which the market will contribute to the achievement of overall corporate objectives. A company which has this truly global approach to its markets and business, therefore, will not think of itself as primarily, say, an American or a Japanese company, even though the company may have been founded in one of these countries and may still have its headquarters there. A global strategy involves a company looking for and planning for global opportunities irrespective of where in the world these occur.

A global strategy may or may not involve standardisation depending on the circumstances of the markets and other factors such as competition, the company itself and so on. However, companies that pursue global strategies are often looking to standardise their business plans as much as possible.

(b) Multi-domestic strategies

Essentially, this strategy is based on developing different strategies for different parts of the world and as such is based on the notion that the differences between markets are more important than the similarities. This approach may still be underpinned by a degree of standardisation, particularly with regard to the process elements of business and marketing planning, but the elements of the marketing mix and, in particular, price and distribution are likely to be adapted. Nevertheless, a company pursuing this type of strategy can still seek to prosper from global opportunities. A company adopting this strategy is often said to be "thinking global, but acting local".

(c) Grouping/clustering strategies: global segments

This approach represents something of a middle ground between the first two strategies and essentially is a segmentation and targeting approach. In this approach customers and/or markets are grouped together according to the similarity of their needs and wants. Once grouped in this way, these customers can then be targeted with a standardised, or at least relatively standardised, marketing mix. Examples of ways in which customers can be grouped and targeted in this way include groupings by geographical area, grouping by trading blocs, grouping by stage of economic development and so on.

Global Branding

Perhaps one of the most significant developments associated with global business and marketing in recent years has been the growth of the global brand. Companies such as Nike, Levis, McDonalds, IBM, Sony, Coca Cola and many more are all successful global brands.

A global brand is generally considered to be a brand with the ***same*** marketing mix ***everywhere*** in the world. However, under this strict definition, it is very unlikely that there is a global brand at the moment or that there will be many in the near future. If, though, we amend the definition to allow for some minor adaptations in the marketing mix between country markets, then we can identify global brands now and it is probable that more will appear in the future. By minor adaptations we would include changes to translate the meaning of the brand packaging into different languages as well as other minor marketing mix changes to accord with country rules and regulations. The substance of the product would, though, be the same in each market and, importantly, the brand name and its trademark would remain unaltered.

Global brands offer some key advantages and benefits both to companies and customers. In the case of companies, global brands facilitate the growth of worldwide customer loyalty. This, in turn, enables easier access to new markets and, in particular, to distribution channels. Finally, a global branding enables a company to build a global presence whilst at the same time achieving global economies of scale in areas such as advertising and promotion.

As far as customers are concerned, global brands often bestow status on the customers who display them. This is particularly important in some of the lesser-developed economies. Similarly, global brands reduce the risks associated with purchase for customers, both in consumer and business-to-business markets. Finally, global brands help facilitate the buying process by making a company's products easily identifiable.

No wonder, then, that global branding has been such a growth area. However, there are disadvantages to developing and supporting the global brand. For example, the business must pay careful attention to managing and co-ordinating brands throughout the world. This can be very difficult where some degree of adaptation is required in different markets. There is also a risk with global brands that if there are any brand scares or problems such as the recent problem with the Mercedes "A" Class product (which initially was found to be prone to rolling over) these can have a very rapid knock-on effect for the reputation and image of the brand throughout the world. Finally, global brands bring the attendant problems of pirating, counterfeiting and parallel imports.

Customised Marketing

Finally, no discussion of globalisation including aspects such as global branding would be complete without a brief mention of the trend towards more customised marketing throughout the world.

There is some evidence to suggest that customers are increasingly looking for customised solutions to their needs – i.e. individual products and brands to satisfy their requirements. Obviously, global brands and standardised marketing are a complete anathema to this. At one time, of course, developing customised marketing mixes for customers would have been impossible apart from in the more specialised markets such as sales of high priced fashion items, industrial products and services and so on. However, a number of developments have begun to facilitate at least a greater degree of customised marketing which at least some customers are looking for. So, for example, manufacturing systems have changed to include flexible manufacturing systems accompanied by CAD/CAM. Coupled with this, as we have seen, businesses now have access to intelligent databases and intelligence systems which enable them to identify more closely the needs of individual customers. Finally, the Internet is increasingly facilitating the speed and ease with which companies and customers can communicate on a real time interactive basis.

Company Size and Globalisation

The very large companies are those that most frequently attempt to change from the polycentric orientation of the multinational enterprise to the geocentric orientation of the transnational global company. These very large companies, for example Ford, Unilever or Procter and Gamble, compete in a substantial way in many markets in the world. They are able to make considerable gains by seeking process and implementation standardisation on a worldwide scale.

Smaller companies are not necessarily prevented from taking a global stance. They are not necessarily smaller in the relative terms of their position in the world market for the products/services that they provide – for example, in the high technology area or, perhaps, in entertainment services. Smaller companies can, therefore, develop both a process and an implementation standardisation in a global way.

Many companies will not consider globalisation because of a limited management view. As we have indicated before, some companies will be confined closely to their own domestic market because of their ethnocentric orientation. Other companies will serve markets that exist in few country markets (the markets for frogs' legs or snake soup, for example) and cannot develop a global view.

Study Unit 10

Market Entry Strategies

Contents ***Page***

INTRODUCTION

For most companies, the strategic decision of how to enter a new country market is of the utmost importance in international business. Once the decision is made and implemented, it will influence the whole way in which the company will pursue its business in that country, particularly in the medium- to long-term. The distribution channel selected has an important influence on all the other marketing mix decisions. Those market-entry decisions which involve investment decisions, particularly the establishment of a wholly-owned subsidiary, are major strategic decisions. In many market-entry decisions contracts need to be signed, for example with agents, distributors and EMCs, and these contracts commit the company in important ways.

Market-entry decisions are initially dependent upon country selection decisions. Once a particular country has been selected, the most appropriate way to enter the market has to be decided. There is no one best way. The decision has to be based upon the company, its objectives, its resources, its international marketing experience, the country chosen and the extent to which real choice exists.

In this study unit we will look at the range of market-entry choices that exist. We will then go on to examine how a selection may be made from the options available and how to approach the vital matter of market-entry decisions.

A. CHOICES OF MARKET ENTRY

Companies have a range of choices for how they can enter a new country market. These can be broadly grouped into two main areas – exporting and overseas production. In addition, companies need to determine the degree of ownership and involvement that they wish to commit to in developing their international business.

Exporting

Most companies, large and small, use exporting as an entrance route for some of their country markets. To generalise, smaller companies often use exporting for all their international business. On the other hand, larger companies will often use a range of exporting, foreign production and ownership approaches. The difference stems from the greater resources of the larger companies and therefore their ability to choose between different approaches.

In the consideration of exporting there are two main divisions – indirect exporting and direct exporting.

- Indirect exporting takes place when the country market is developed through distribution intermediaries, such as export management companies, who are based in the same country as the exporting company.
- Direct exporting takes place when the distribution intermediaries used are based in the country market that is the target for the exports – for example, agents or distributors.

(a) Direct exporting

The main methods of entering foreign markets through direct exporting are as follows.

(i) Distributors

A distributor earns a profit by selling products which have been previously bought by the distributor. Distributors usually have a salesforce and provide some logistics and marketing inputs in addition to the sales function.

(ii) Agents

Agents act on behalf of a principal. In the case of export distribution, the agent sells products on behalf of a principal who is based in another country. The agent provides a sales function but does not own the product that is sold. Agents receive lower levels of sales commissions than distributors because they provide fewer services to the principal. Agents are usually smaller organisations than distributors – they may be one person, who acts primarily in a sales capacity.

Agents are similar to distributors in that they often represent a number of companies, sharing their time and efforts between a number of products and clients. The companies that use agents and distributors need to manage them to motivate them to sell their products. There is a tendency for agents and distributors to "cherry pick" in the sense that they put their main efforts behind those products that are easiest to sell and those that provide them with the best profit earning possibilities.

(iii) Company sales force

A company can use its own salesforce to sell in another country market. If the market potential is sufficiently large, the company can use salespeople who are based in that country. If the market is smaller or risky, the company is more likely to use salespeople who merely visit the country and its customers from time to time.

An important consideration in using this method of market entry is the nature of its cost. Most of the costs of using the company salesforce are fixed or indirect costs. This means that if the level of sales is poor, the same indirect costs will be spread across a small number of sales.

The decision as to which entry route is appropriate will partly relate to company experience in international business, but it will also relate to the type of product. If the product requires high levels of after-sales service, then there will be a need for in-country presence and service capability. Some companies have the resources to be able to carry out customer-responsible servicing, while other companies will need to delegate this to local companies. If this is the case, the company would need either to appoint a distributor to carry out these tasks or to appoint a service company in addition to the agent.

(b) Indirect exporting

Indirect exporting is the method used by companies that wish to reduce their risk and exposure to international marketing. It is a way in which companies can attempt to sell some of their excess capacity without incurring the problems associated with dealing with customers in different countries. The main problem with indirect exporting is the lack of control over how the company's products are marketed. It is quite common for the company to be unaware of who its customers are and how some of the marketing mix elements are used – for example, being unaware of the final price charged to customers.

The main methods of entering foreign markets through indirect exporting are as follows.

(i) Export management companies

Export management companies have similarities with agents and distributors but are different because they are based in the exporter's own country. For the exporter, the export management company seems easier to deal with because of the absence of language, cultural and export documentation difficulties. Export management companies are sometimes called export houses and sometimes export marketing companies (EMCs).

EMCs, by selling a range of products, can offer an interesting package of products to foreign buyers whilst at the same time splitting the costs of selling, marketing and physical distribution across a number of products from different client companies. EMCs usually specialise in some way, for example by part of the world, by product type or by type of customer. An EMC might therefore sell toys to retailers in Asian countries on behalf of UK companies. The company is able to have its products sold into a large number of country markets.

(ii) Piggyback operations

This method of market entry is based upon use of the established distribution arrangements of one company by another company. One company gives "a ride" to the other company. The ride consists of the selling and export administration, and benefits from the ongoing nature of the sales contacts that the company has. The "rider" company receives an immediate benefit by gaining access to the working system that has been built up by the other company. The "carrier" is either paid a commission and acts as an agent, or buys the product and acts as a distributor.

(iii) Purchase in domestic market

Some companies sell their products to companies that send buyers, or who have established buying offices, in the domestic market of the selling company. Some large retailing companies from countries such as the United States or Japan will buy products in this way. This method, whilst creating export sales, keeps the selling company away from a direct understanding of the country market and minimises their need to handle the full range of export documentation.

Overseas Production

Overseas production in the country market will rule out exporting. There will be no need to transport products physically across country borders as the products will be produced within that country.

There are a range of methods of achieving foreign production.

(a) Wholly-owned subsidiary

This would be a company set up in another country which is 100% owned by the parent company. A wholly-owned subsidiary with a complete production facility is the most obvious means of achieving foreign production.

(b) Foreign assembly

The company could produce most of the product in the domestic market and merely assemble it in the country market.

(c) Contract manufacture

The company could arrange for another company to produce the product for them through contract manufacturing.

(d) Licensing and franchising

The company could use licensing and franchising methods, which would result in other companies being responsible for production.

Licensing is a method of market entry in which a company, for a fee or royalty payment, allows another company to use a patent or a trade mark within the areas defined by the licensing agreement. Licensing is a low-cost, low-risk way to enter markets. The enterprise is only

directly involved with the market through the company with which it has its licensing agreement. It is a method used by small and medium-sized companies, particularly those in advanced technology, because it enables quick returns to be made with the use of extra capital.

The various difficulties with licensing relate to the usual low profit returns from licensing, and the difficulty in selecting suitable licensees. It is not uncommon for licensees to use the licence as a quick way to learn about new products and new technologies. In this way the licensee can often become a competitor. Another difficulty with licensing is the lack of market control.

There are similarities between licensing and franchising. The main difference is the extent to which a marketing programme is assigned to the franchisee. In licensing agreements, the licensing might well be restricted to the trademark. In ***franchising***, the agreement often covers the trade mark, the logo, the particular method of operation, and sometimes advertising campaigns. Franchising is particularly used in fast food operations (for example, Kentucky Fried Chicken (KFC) and Burger King) soft drinks (for example, Coca-Cola and Pepsi-Cola) and car rental (for example, Hertz and Avis).

Ownership Strategies

Companies will need to decide on the level of direct ownership they desire in market-entry decisions. The extreme positions are complete ownership or complete reliance upon other companies, with the intermediate option of entering into part-ownership schemes.

Ownership decisions will usually be corporate strategic decisions in addition to operational and marketing decisions. The decision will be strongly influenced by the level of political and economic stability in the chosen country. The higher the level of risk of interference, the more likely it will be for the company to want others to bear the risks of ownership.

Distribution-channel decisions have important and relatively long-term consequences for companies. The decision to include company ownership as part of the distribution-channel decision serves to increase the commitment and results in a major medium- to long-term view being taken about the market.

The following represent the major alternatives with regard to ownership.

(a) Wholly owned

Here, the alternatives are the setting up or acquisition of a subsidiary in the country market, or using the company's own salesforce. Both these methods have been outlined above

(b) Partly owned

There are two main possibilities for part ownership of foreign companies – the joint venture and the strategic alliance.

(i) Joint venture

A joint venture is a kind of partly-owned subsidiary in which a multinational enterprise decides to share the management of a company with one or more collaborating firms. The reasons for entering into a joint venture are often to reduce political and economic risk. In some countries, joint ventures might be the only way in which a company can invest in the country (this is usually called inward foreign investment). Other reasons for using joint ventures include using the specialist skills and cultural knowledge of a local partner, to gain access to the distribution channels of a joint venture partner, and as a means of limiting the capital requirement of international expansion.

(ii) Strategic alliance

There are differences between joint ventures and strategic alliances. In a joint venture, two or more companies contribute specific amounts of capital to form a new company. In strategic alliances the arrangements between, usually, two companies are more flexible. The alliance may or may not result in a new company. The usual purpose of a strategic alliance is to combine and gain benefits out of each partner's skills and resources.

Alliances are a comparatively recent method in international business. It is possible that the very flexibility of the alliance will result in its eventual transition into a new company or a more formal joint venture, or the take-over of one company by the other.

Alliances are most common in connection with providing access into distribution channels (market entry) and also as a means of gaining research and development expertise for new product development and manufacturing capability.

(c) Owned by others

Here, the strategy will be to operate through separate companies, the methods including those considered above such as licensing and franchising, distributors and agents, and EMCs and piggyback operations.

From this, we can see that the degree of involvement, in terms of ownership and commitment, in the country can range from high to low:

Figure 10.1: Spectrum of ownership options

High involvement	↑	Wholly-owned subsidiary
		Partly-owned joint venture
		Strategic alliance
		Licensing/Franchising
		Distributors
		Agents
		Using the company salesforce
		Export management companies
		Piggyback operations
Low involvement	↓	Purchase in domestic market by buyers from other countries

B. SELECTION OF MARKET-ENTRY ROUTES

A company's selection of market-entry routes is a key organisational decision and will depend upon a series of factors. The main factors are:

- Potential for sales generation
- Potential for profit earning
- Investment payback period

- Balance of costs between direct and indirect
- Exposure to risk
- Speed of achieving market coverage
- Degree of control
- The match between the requirements of the product/service and services provided through the particular market-entry route.
- Sources of global finance to support entry strategies.

A company is likely to have different marketing objectives in different countries. In some countries there might be significant long-term potential, in which case the company would wish to follow a key market concentration approach. In other markets, the levels of risk might be high or the sales potential might be low so the company would be looking for low commitment methods of market entry. Therefore, the preferred market-entry method will vary from country to country.

In the previous section the market-entry choices were listed in order of involvement in the country market (Figure 1.1). The market-entry method with the highest involvement is to set up and run a wholly-owned subsidiary. The company becomes extensively involved in the country because it is manufacturing and marketing there. The selection of this entry method has major consequences for the company. The fixed nature of the assets needed to establish the subsidiary makes the company vulnerable to changes in the political and economic management of the country.

At the other extreme, the company that sells its products in its own domestic market to buyers who will sell the product in other country markets, has a very low involvement or no involvement at all in that country market. When looked at from a sales and profit-generation perspective, the wholly-owned subsidiary route offers the possibility of large returns that could grow substantially. The domestic sale route, on the other hand, provides quick but comparatively small sales and profit opportunities, with very limited opportunities to expand the business in the future.

The preferred market-entry method might also not be available or might be blocked in some markets. For example, the company might wish to establish a wholly-owned subsidiary, but find that country regulations only allow a joint venture with a local company. Even then, the company might not be able to find a suitable joint venture or alliance partner. Where the ideal strategy for a company may be to use an agent as the means of entering a country, it is quite possible that there will only be a few good quality agents – those with the requisite geographical coverage, technical knowledge of the product, or customer base. However, the agents that exist may be already contracted to competitors, in which case the company would need to find a different strategy to gain market entry. In countries with distribution systems that have been subject to considerable adaptation through cultural influences, such as Japan, it will be particularly important to select distribution partners who have the right customer contacts.

We will now look at the various selection possibilities for each of the main market-entry methods.

Sales Generation

Companies will be concerned about the speed with which sales will grow in the country. Obviously companies would prefer sales to grow rapidly, provided that they have the production and organisational capability to sustain the growth. The slowest method of increasing sales will be the wholly-owned subsidiary – the company needs to be established and production levels built up before sales can begin, and this might take a number of years. The fastest methods of generating sales are to use companies that are already established in the country and who are regularly selling to the right

type of customer. In this way the extra lines for the new company are added on to the sales list and sales can therefore begin almost immediately.

(a) Wholly-owned subsidiary

For the generation of sales, this will be the slowest of all methods, but in the long term this offers the highest total sales.

(b) Joint venture/strategic alliance

The initial sales generation will be slow because of the need to find, and to negotiate a suitable agreement with, a partner. Once this is completed, sales can develop rapidly, because one of the normal bases of the agreement is the local knowledge and distribution capability of the other partner.

(c) Licensing/franchising

Initially sales will be prevented because of the need to find the correct companies for the licence or franchising deal. Once this has been achieved, sales can take off rapidly. The extent to which sales grow rapidly will depend upon the qualities of the licensee or franchisee.

(d) Agents/distributors

Sales are most likely to develop more quickly through this method than from other methods. Agents and distributors have already established contacts so sales could commence at once. In practice, the initial sales levels will be influenced by the unknown nature of the product and the company in that country.

(e) Own salesforce

Sales will start slowly because of the need of the salesforce to establish contacts with suitable customers. To sell successfully, the various linguistic and cultural barriers will need to be overcome.

Profit Earning Capacity

Organisations are very concerned about profit-earning capacity. This criterion will have a strong influence upon the final decision about which method to use.

(a) Wholly-owned subsidiary

This will be the slowest way to earn profits, but again in the long run it offers the highest profit potential.

(b) Joint venture/strategic alliance

These have moderate to high profit-earning capabilities. The shared costs and the input of expertise from the partner organisations give good chances of profits, provided that the partners have been selected carefully.

(c) Licensing/franchising

Licensing gives a less strong profit payback because of the limited basis on which the company providing the licence acts in the arrangement. In franchising, the wider range of marketing mix activities employed and a more proactive approach give a better rate of profit return.

(d) Agents/distributors

The profitability from these two methods is comparatively modest. Profit flows will start quickly, but will not grow to the potentially high levels achievable from most other methods.

(e) Own salesforce

Initially the high indirect costs will eliminate the possibility of profits for anything more than infrequent "flying" sales visits. If the company establishes a resident salesforce in the country, it will take some time before customer contacts and sales negotiations will generate a flow of sales revenue sufficient to cover costs. For some very large sales of capital equipment, for example Rolls Royce aero engines, the high profit potential from one order will make it worthwhile to base a large team of company personnel in the country to negotiate the order.

Investment Payback Period

The wholly-owned subsidiary route will take a long time before the breakeven point is reached and even longer until an overall profit point is reached. The shortest payback periods are for agents and distributors. Here the initial investment costs relate to the costs of searching for suitable agents and distributors and the costs of training them in the company products and systems. Costs will include travel expenses and may include visits of the agent/distributor to the company's headquarters.

Balance of Direct and Indirect Costs

The agent/distributor costs are primarily based upon direct costs that relate specifically to the sales of the product. Indirect costs related to training programmes and other non-sales-related costs will be incurred, but in the main the costs are direct. All other methods have a higher percentage of indirect costs and these will be at their highest in the wholly-owned subsidiary.

Exposure to Risk

This will be lowest in the case of agents and distributors and highest in the case of wholly-owned subsidiaries. The main risks with agents and distributors are that they will:

- Not gain sales
- Underachieve agreed sales targets
- Alter the marketing mix without prior agreement.

It is important that the contract signed allows the company to cancel the agreement without legal difficulty if the agent/distributor fails to deliver his or her side of the bargain.

Speed of Achieving Market Coverage

For some companies it will be important to gain widespread distribution very quickly. This is most likely to be the case for consumer products, which will be supported with national marketing communications programmes. Other companies might wish for a rapid build-up to beat competitors into the market-place.

The fastest methods of gaining market coverage will be through the use of agents/distributors. However, appropriate companies need to be selected and trained before sales can commence. This is, though, a much quicker process than the other methods. Agents/distributors will have an existing customer list which can be activated very quickly.

Usually individual agents/distributors will only cover part of a country. In order to gain complete national coverage a number of agents/distributors will be required.

Degree of Control

The degree of control relates quite closely to the degree of ownership. The agent/distributor route offers little control as they are likely to have their own organisational objectives. They will usually

handle the sales of a number of other products and the company will need to plan and manage agents/distributors to gain the best performance from them. In licensing and franchising, the ability to control will relate directly to the contract. In joint ventures and strategic alliances, control has to be balanced between the participants. In some situations the battle for control can cause the venture to disintegrate. It is only in the company salesforce and the wholly-owned subsidiary that the company has complete control.

Match Between the Product and Market-Entry Route

It is sometimes difficult to find the correct blend of services provided by other organisations. In some countries there may not be a tradition of providing that particular product at the desired service level. In other countries the organisations may exist, but be contracted already to competitors. Because of this, companies will often have to accept a less than ideal situation and rectify the deficits through inputs from their own company. Sometimes, of course, the solution will be through a wholly-owned company operation.

Sources of Global Finance to Support Entry Strategies

A final factor affecting the choice of entry strategy concerns the availability and sources of finance to support any proposed entry strategy. We have already seen that the different entry strategies involve different commitments with regard to the initial levels of investment required. So, for example, entry via a wholly-owned subsidiary will require much higher levels of investment than, say, using piggyback operations as a method of entry. We can also see that often a company which would otherwise prefer to select a more direct entry strategy may be forced to use one of the more indirect entry strategies simply because of lack of capital. The business, therefore, must be aware of the financial investment implications of the range of entry strategies and also some of the sources of global financial capital which might be available to support a preferred entry strategy.

Obviously, a company can use its own internally generated funds to fuel overseas expansion and such funds, of course, are generally cheaper than external sources of finance. Where internal finance to support a proposed entry strategy is not available, then the company can turn to the conventional external sources of finance such as banks, share issues, etc. In addition, however, when it comes to funding entry strategies, the business can also draw upon a number of other potential sources of global finance to support a proposed entry strategy.

(a) Host governments

Sometimes the government of a country which the business wants to enter may be prepared to offer financial incentives and inducements. So, for example, the United Kingdom government has, in a variety of ways, provided special financial incentives to Japanese companies wishing to invest in direct manufacturing facilities in the United Kingdom. Clearly, there are a number of reasons for such financial incentives, such as boosting local employment and providing access to new technologies and skills which would otherwise not be available.

(b) International funding bodies

International organisations such as the World Trade Organisation and the International Monetary Fund will, under certain circumstances, help companies to build up their international trading activities.

(c) International venture capital

Increasingly, there is now a global fund of capital available to companies who are wishing to exploit international business opportunities. These global funds are operated by venture capital companies sometimes connected to, for example, the larger world banks. Such global capital

funds began to develop in the 1960s and, some say, have in the past been a major source of international financial instability inasmuch as they are often operated outside the control of individual governments.

(d) Customers

Particularly in business-to-business markets, customers may help provide finance to help a valued supplier invest in overseas markets. We have seen that increasingly business customers are seeking to develop long-term relationships with suppliers to maximise the potential of all the value chain activities in competitive strategy. Some of the larger global companies will often help a smaller supplier invest in, say, manufacturing facilities in a country in order to ensure effective just-in-time delivery.

C. THE MARKET-ENTRY DECISION

The decision on which market-entry method to use is, as we have said, one of major strategic importance. It is a decision that many established businesses have not taken before.

In the domestic market, few established businesses have to make conscious decisions about which distribution channel to use – in most situations these decisions will have been made previously. The main activity is based upon improving and enhancing the existing distribution arrangements and in using the other elements of the marketing mix.

In international business, the large number of country markets around the world give rise to various opportunities to decide upon the best form of market entry. It is unusual for companies to market their products in every country. It is quite common for companies to be restricted to less than 50 country markets.

The decision approach to market entry can be made on subjective or on objective grounds. The significance of the decision strongly supports approaches which attempt to be systematic and to use formal evaluative criteria.

Subjective Approaches

Elements of subjectivity are inevitable because of a lack of complete and reliable information. It is difficult to obtain factually correct data about prospective agents, distributors or joint venture partners. It is always difficult to forecast future sales. It is particularly difficult to forecast sales in a new situation. Once the company has been established in the market, it can use past sales data to help in the forecast of future sales. The company needs to make judgments about the various information gaps and it is therefore forced to make decisions which have various amounts of subjectivity contained within them.

The most common subjective approach would be to use a particular market-entry method because that is the way that the company has entered other company markets – for example, the company uses agents in its other markets and therefore automatically looks for agents when it wishes to enter a new country market.

The most likely market-entry routes to be the subject of the less rigorous subjective approach are the use of the company salesforce (especially if the salesforce remains based in the domestic market), the use of agents and distributors, and sales which are made domestically. All of these approaches restrict the risk to the company. If things go wrong, the company will not suffer major loss. It is worth remembering, of course, that the company could be missing substantial sales and profit opportunities by selecting inappropriate market-entry approaches. Because the “lost” sales can only be estimated, it is easy for the company to ignore the missed potential.

It is unlikely that a company will take a subjective approach with distribution methods that require a lengthy period to pay back the initial investment. Therefore, the wholly-owned subsidiary particularly, but also the joint venture, strategic alliance, licensing and franchising would normally be evaluated in a formal way.

Objective Approaches

It is advisable for companies to examine the advantages and disadvantages of each entry method before making a decision. You will see already that it is improbable that any one approach will have no drawbacks. The final decision will not be easy. Furthermore, the decision will be based upon imperfect information. It is difficult to estimate what the future demand patterns will be for each of the market-entry approaches. Will agents generate more sales than distributors? How easy will it be to motivate agents? If we set up our own wholly-owned subsidiary, what will the economic and political situation be in five to ten years' time? These and other questions make it very difficult to develop a reliable evaluation of the market-entry options.

The two main approaches that companies can take are to:

- Evaluate market-entry options through applying scores to the different options.
- Carry out a computer simulation to estimate expected revenues and profit paybacks.

The decision between the two will be influenced by the importance of the decision to the company and its sophistication in using decision-making techniques.

The more the decision is based on reliable information, the more likely it is that the decision will be successful. Thus, subjective judgment should be minimised and the company needs to collect the information necessary to make a rational decision. However, the cost and the time taken for this is likely to influence the way in which it is approached.

(a) The weighted factor score method

The weighted factor score method can be used in all situations, even if information is limited, and is preferable to complete subjectivity.

The method works by the company establishing the major factors that it should consider in making the decision and assigning weights to reflect the relative importance of each factor. Each option can then be rated against these factors and compared to identify the best option.

If we take an example in which some of the options have already been eliminated because the company wishes to gain direct contact with the country market, this leaves eight options – using the company salesforce, agents, distributors, licensing, franchising, strategic alliance, joint venture and a wholly-owned subsidiary. Assuming that the company wishes to develop its international sales rapidly and in the long term achieve a substantial global position, the factors that would be relevant and their weightings might be as shown in Figure 10.2.

Figure 10.2: Factor weightings

Factor	**Factor Weight** *(A)*	**Factor Score** *(B)*	**Rating** *(A × B)*
The speed of sales growth	0.3		
Investment payback period	0.1		
Amount of learning about international markets	0.2		
Degree of control	0.1		
Long-term profit potential	0.3		
Total Score			

The total scores for each of the options can be calculated. In this way the company will make a careful evaluation of each option. Subjectivity is still part of the process. There are elements of subjectivity in deciding which factors to include and which to exclude. The factor weights and the factor scores both contain elements of subjectivity, but, nonetheless, it does provide a useful way to make the important market-entry choice.

(b) Simulation method

A computer simulation could be developed to quantify the profit and sales revenue positions for each option. The options could then be decided by reviewing the payback period, the return on capital employed, the market share obtainable and other similar measures.

To be able to compute the solutions, various estimates would be needed to forecast sales revenue, profit contributions, marketing mix expenditures (for example, on advertising and sales promotion), the capital expenditures and the probability of results being achieved. The estimation of all this, and other, information would again involve making subjective judgments about the future. However, the advantage with this method is that it encourages a comprehensive review of costs, revenues and profits for each of the options.

Study Unit 11

International Product Management

Contents ***Page***

INTRODUCTION

In this study unit we move on to the area of the syllabus concerned with implementation and control in international business. A substantial amount of this is concerned with managing the elements of the international marketing mix, including the extended mix for services. In this particular study unit we shall be looking at the issues in international product management.

Throughout the study units encompassing the marketing mix elements, including this one, it is important to remember that many of the concepts, techniques, decision areas and management issues are very similar to those encountered when considering purely domestic markets and marketing. So, for example, many of the issues in product decisions – such as how to differentiate the product and manage the product mix and the product portfolio analysis, etc. – are in essence much the same as we find in domestic marketing. Our focus throughout these study units will therefore primarily centre on looking at the additional issues, complexities and management issues which arise in planning these mix elements for international markets. We shall find throughout our discussion that the continuing theme of standardisation versus adaptation, which we have already seen in earlier study units, also runs throughout the issues in managing the mix elements.

A. PRODUCTS

The management of products in international business can be thought of as including the following activities:

- Deciding products to be sold throughout the world.
- Deciding which products need to be adapted to local conditions and in which country markets.
- Deciding which products need to be modified to keep them up-to-date and in which country markets.
- Deciding which new products should be developed into which country markets.
- Deciding which products should be eliminated and in which country markets.
- Deciding which brand names to use.
- Deciding on packaging.
- Deciding on after-sales services that relate to the product, for example warranties.

We can see from this list that, as already mentioned, many of these activities connected with the management of international products are also found when marketing on a purely domestic basis. However, the addition of marketing across national frontiers creates several additional considerations and complexities which are simply not encountered in purely domestic marketing. We shall start by examining the notion of the product mix and its management.

Product Mix

A good starting point in our examination of products is the product mix concept developed by Kotler. The product mix is based upon a number of concepts.

(a) Product qualities

The product operates at three levels:

- the ***core*** is the basic benefits or services provided;

- the ***tangible*** product is the quality level, the brand name, the packaging, the styling and product features; and
- the ***augmented*** product is concerned with warranties, after-sales service, installation, delivery and credit.

Whilst all three levels of the product will appeal in different degrees to buyers in different parts of the world, it is noticeable that the augmented product is particularly vulnerable in export marketing. It is much more difficult for the exporter to provide delivery and after-sales services than it is in the home market so exporters will usually rely on other companies to provide these services for them. This separation can give customers anxiety not only about the consistency and the reliability of those services but also about the advisability of buying the product in the first place.

(b) Product lines and items

Products can be grouped into ***product lines***. Product lines are products that are closely related – for example, within the Ford product mix we can identify several different product lines such as Fiesta, Escort and Mondeo. Each separate product is an ***item***.

The product mix can be analysed for the coverage of the market by considering the number of product lines, and the number of items in each line. The greater the number of items, the greater is the degree of customer choice and the greater the extent to which the consumer is being segmented. In the illustration below, four product lines with their associated product items are identified.

Product line	A	16 items
	B	4 items
	C	26 items
	D	10 items
	etc.	

The ***width*** of the product mix shows the number of product lines. The ***depth*** is the average number of different items in each product line. In this example, product line C has the greatest depth. The overall ***consistency*** of the product mix can be evaluated through the development of specific criteria. In this way, for one company it might be appropriate to examine consistency by the use of the same distribution channels and for another by the uses which the customer has for the products.

The product mix concept is a useful way to make an analysis of the products offered by a company in its different country markets. The competitors in each market can be compared by the different compositions of their product mix. A point to remember is that product mix is usually easy to obtain via the company list of products or its price list.

If more information is available, the contributions that product items and product lines make to company sales and profits can be calculated and compared in each country market.

We can see that the product mix concepts outlined here are no different from those considered in domestic markets. However, the greater spread and different types of markets encountered by the international business often requires it to market a much wider and more disparate product mix. So, for example, the overall consistency of the product mix may be much more difficult to manage when considering international markets. There is one concept, however, which is entirely unique when considering product management in international markets – the so-called **country of origin** effect.

Country of Origin Effect

The country of origin of a product can have a positive, neutral or negative effect on the sales of that product and this effect is not necessarily constant throughout the world. In some instances the country of origin effect for products made in Germany and Japan may be consistently good. In Asia, some countries might be perceived to be good producers of products in other Asian countries, whilst in general Asian products overall might be thought of in a negative way by US customers.

A number of studies have shown that the country of origin effect does exist and that it does influence sales levels. However, there are practical difficulties in these studies. It is difficult to isolate the "origin" effect from all the other influences. It is also difficult to separate the country of manufacture from the home country of the manufacturing company – for example, Saab, a Swedish car manufacturer owned by the US company, General Motors, may have some of its cars made in Finland, so is the country of origin Sweden, the US or Finland? A further difficulty is the way in which legislation on labelling influences the "origin". A product may be made with components made in a number of different countries and then assembled in another country. Or the product might be substantially made and assembled in other countries, but with a minor finishing process to allow the country of origin label to specify the country in which the minor finishing took place.

The general points which have emerged from these studies about country of origin are as follows:

- Consumer buyers in industrially advanced and newly industrialised countries are influenced by the country of origin in many different classes of products – for example, cars, clothes, watches and cosmetics.
- Business buyers are also influenced by the country of origin, but generally to a lesser extent than consumer buyers.
- The influence changes over time – for example, many years ago the country of origin effect for Japan was negative, but over the past years this has changed to be very positive.
- The country of origin effect is not consistent between countries.
- Buyers – consumer, business and government – tend to rate their own domestic country products more highly than buyers in other countries. (But note the next point.)
- Buyers in developing countries might consistently prefer foreign origin products. This preference might change as the developing country progresses and becomes able to produce better quality products.
- There is often a negative attitude towards products produced in developing countries. This will affect products from many countries in Asia, Africa, Latin America and Central and Eastern Europe.

B. TECHNIQUES AND CONCEPTS IN INTERNATIONAL PRODUCT MANAGEMENT

A number of techniques and concepts are appropriate to the international management of products. Again many of these techniques and concepts can also be used for purely domestic product management and marketing, so once again we shall consider the special issues and considerations when applying these techniques and concepts in an international setting. Three particularly useful techniques and concepts are discussed below.

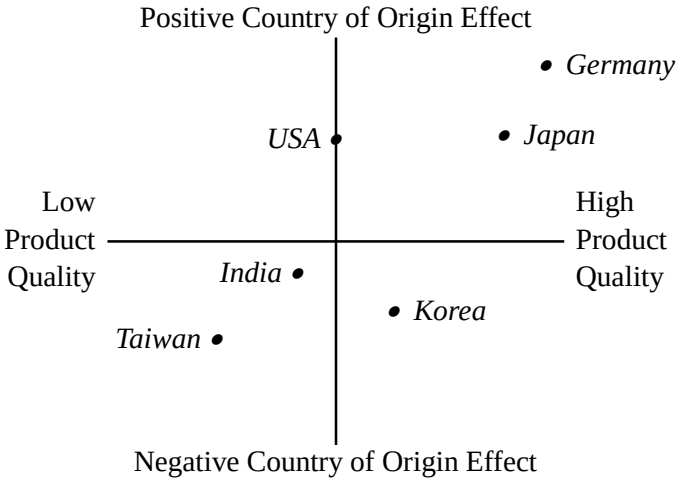
Positioning and Perceptual Mapping

You should, of course, already be familiar with the concepts of positioning and the techniques of perceptual mapping in the area of product management.

We know that it is useful for the business to determine where a product or brand is to be positioned in the market with regard to competition. In particular, the business needs to ensure not only that a product or brand occupies a clear position in the market, but also that it occupies a clear position in the mind of the customer. The technique of perceptual mapping therefore concentrates on the fact that positioning actually takes place in the mind of the customer and it is ultimately customers' perceptions which determine the position which a product or brand has in the market. By using the techniques of perceptual mapping, therefore, the business can investigate how products or brands are seen by customers compared to the competition, and on this basis determine the most effective positioning strategies.

A number of dimensions or attributes are used by customers to arrive at a perception of products but a simple two-dimensional map based on just two attributes is shown below to illustrate the concept of positioning. Figure 11.1 shows a possible interpretation of the country of origin effect with low/high product quality.

Figure 11.1: Perceptual map



Perceptual mapping is a useful technique for charting the relative positions of many different issues in international business. For example, it can be used to evaluate the customer's perception in different countries – the Mercedes brand is perceived as being very high-quality and prestigious in the United Kingdom, but less so in other countries of the world where it is frequently used as a taxi. Similarly, a company can look for gaps in the market where, for example, there is no current brand in a particular position. Finally, the perceptual map can be used to find new ways of differentiating a product or brand from its competitors.

Product Portfolio Analysis

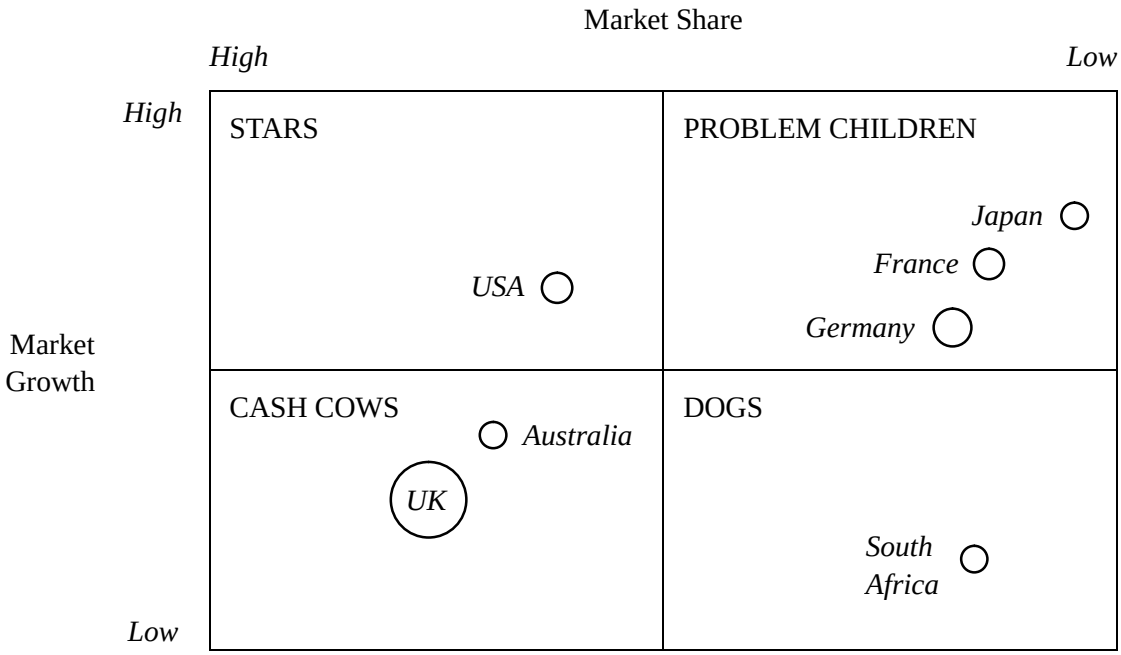
Portfolio approaches have been used for a number of years in marketing and corporate strategy to help analyse the strategic position of the company and to help identify options for future actions. They are based on taking a complete view of company products and comparing their performance in a number of ways – for example, to compare product performance across country markets, to compare

competitor portfolios, or to compare country markets themselves, on their own or grouped in various ways to take account of trading blocs or other regional groupings. By doing this, the company should be able to use its resources in a more strategic way.

The best known of the portfolio approaches is the Boston Consulting Group's growth-share matrix. The standard BCG matrix can be used as a tool in international business and marketing strategy.

The example in Figure 11.2 takes one product that a company provides and then plots, on the portfolio, its relative market share and the rate of market growth in different country markets. As is normal for the BCG approach, the size of the circle relates to the amount of sales for the company concerned. The example is based on a UK firm and shows the UK market representing the largest sales of the product. The lack of "Stars" would be a strategic concern for the company.

Figure 11.2: BCG analysis across international markets



There are a number of limitations with portfolio analysis, despite its obvious popularity. The main limitations are:

- It is often difficult to obtain accurate measurements of the total market size, the growth in the market and the market shares of the main participants in the market.
- The way in which the market is defined will influence market growth rates and market shares. Different ways of segmenting the market will influence different market definitions.
- It is very difficult in international business to obtain reliable information that can be compared accurately across a number of different countries. Therefore, the positions shown in the portfolio could be influenced more by measurement differences and errors than by real differences in product performance in different countries.
- In some markets the basic relationships, that are at the heart of the BCG concept, might not be valid. For example, there might not be any great cost advantages in achieving a high relative market share, and low market growth may not give rise to lower levels of competitive activity. If competitive activity remains high, despite a slowing down in market growth, then the cash cow position is much less favourable. Some of the cash that would have been retained by the

company will have to be used in price discounting and extra marketing communications in order to defend the product position.

The Product Life Cycle

You will, of course, already be familiar with the product life cycle concept from your earlier studies, but is this concept relevant and useful in international business? The simple answer is yes.

The product life cycle concept, you will recall, is based on the notion that products pass through a series of stages during their life in the market and that at each of these stages the appropriate marketing strategies will differ. In international marketing, we often find that products are at different stages of their life cycles in different countries. So, for example, in the United States, home computer ownership is towards the end of the growth period of the life cycle, whereas in the United Kingdom ownership is really just taking off in terms of growth. Therefore, marketing strategies that are appropriate in the United Kingdom to try and promote further growth are different to those that would be applicable in the United States.

As well as using this difference in product life cycles to identify appropriate marketing strategies in each country, it can also be used by the international business to identify potential new markets for products. So, for example, as one market begins to mature and decline, the business can search for marketing opportunities in countries where the product is at early stages of growth. In this way, we can use the product life cycle to plan product roll-outs across countries in different parts of the world.

Needless to say, all the problems and criticisms of the product life cycle concept, such as problems of identifying and forecasting stages, also apply to using the concept in international planning. In addition, with respect to the notion that different products are at different stages in different countries, developments in the speed of global communication, increased travel on the part of customers, etc. mean that to some extent product life cycles have tended to “equalise” across national boundaries. However, the product life cycle concept remains a useful one in the context of international product management.

C. BRANDING ISSUES

Branding strategies and concepts are crucial aspects of developing marketing strategies in all markets. However, if anything, branding and effective brand management takes on an increased importance in international marketing. It is particularly crucial in the positioning process for products in international markets, where often a consumer may be entirely unfamiliar with anything else other than the international brand name and will therefore tend to rely heavily on the brand name in product choice.

Let us now consider some of the elements of brand strategy and decisions and see how these relate in particular to international marketing.

Branding Strategies

The four main branding strategies are as follows:

- Company brand linked with a generic product description – for example, Heinz Baked Beans.
- Range branding which is used by companies with a range of different product groups – for example, Unilever use Walls for ice cream, Birds Eye for frozen food, etc. Range branding can be broken down further. Birds Eye uses a number of different range names for complete frozen meals, fish products and vegetables.

- Individual brand names which can be used without any major reference to the company name – for example, Procter and Gamble use Daz without an obvious reference to P and G, whereas Cadbury's Flake shows a branding position in which the brand name "Flake" is dependent upon the company name.
- Own label is a branding strategy in which a company provides a product for a distributor or another manufacturer. It is that distributor or manufacturer that adds a visible company or brand name to the product.

The same branding strategies apply in international business. However, great care needs to be taken as the company attempts to expand its sales through market development activities of moving into new country markets. The company needs to check the following:

- Is the brand name pronounceable in the country language?
- Does the brand name have a favourable, neutral or unfavourable meaning?
- Is the name one that can be registered so that legal protection can be gained for the brand name and the trade mark?

It can be the case that a company wishes to develop one international brand that it can standardise across the world, but that it is frustrated by previous registrations of that name in some country markets and by unfortunate meanings of the brand name in other markets.

Counterfeiting and Pirating

Product counterfeiting and pirating is the unauthorised use of industrial and intellectual property rights. These rights would include patents, product design and trade marks.

Many products are the subject of counterfeiting. Usually producers from newly industrialised or lesser developed countries copy the product and brand naming of products produced in more industrially advanced countries. The product groups that are particularly affected are cosmetics, watches, clothing, music and toys. It is also quite common for business products to be produced by "spurious" suppliers who counterfeit car components, pharmaceuticals, chemicals, etc.

(a) Approaches

A number of different approaches are taken in counterfeiting:

(i) Piracy

This happens when the product and the brand are intended to look like the "real thing". The resemblance is usually concentrated upon the external design and the trade mark. Rolex watches are a particular target of piracy.

(ii) Design copying

The product design is copied but not the trade mark/brand name. Sometimes the difference in the brand name is quite small, in which case it is, in effect, piracy.

(iii) Trade mark or brand name copying

In this case, often with clothing, it is the brand name that is the subject of counterfeiting. The product itself might be quite different from (and probably inferior in quality to) the original product.

(iv) Cloning

In this case the brand name and the product design are kept close, but not identical to the original. The main technical elements of performance, as in the case of the cloning of IBM personal computers, could be developed to the same technical specification.

(b) Protection

The main forms of protection against the counterfeiting of intellectual property rights are through patents, trade marks and copyright.

- Patents protect original ways of doing things.
- Trade marks protect a name, sign or symbol.
- Copyrights protect the physical expression of ideas.

There are very considerable problems in using the legal system to protect intellectual property rights in various countries. The last GATT round, the Uruguay Round, included intellectual property rights in the negotiations. The US, in particular, is aiming to prevent the lost trade that is "stolen" by counterfeiters. Various estimates place counterfeiting as reaching several percent of the total world trade. Various countries are particularly associated with the supply of counterfeit goods; these include China, Thailand, South Korea, India, Brazil and Mexico.

D. NEW PRODUCT DEVELOPMENT

New products can be developed in any part of companies, but the most usual place for new product development to take place is the country of the company headquarters. In major multinational and transnational companies, research and development capability will exist in several countries. This means that the larger companies might innovate products from a number of parts of their organisation.

The Process of Product Development

The new product development (NPD) approach is based upon the following stages:

- Idea generation
- Initial screening
- Business analysis
- Development
- Market testing
- Commercialisation.

The particular ways in which the stages take on extra dimensions in international marketing are as follows:

(a) Idea Generation

It is important to stimulate and search for ideas on a worldwide basis – from lesser developed, newly industrialised and industrially advanced countries. Newly industrialised countries are usually economies with high levels of growth, it is important to take that opportunity into account when developing new products. Ideas are much cheaper than the later development and commercialisation stages. It is vital that good ideas are gained.

(b) Initial Screening and Business Analysis

Criteria need to be developed to avoid errors so that ideas that would have developed into successful new products are not rejected. Thus, the company needs to develop a reliable way of screening the obviously unsuitable ideas.

It should then carry out a thorough customer appraisal, a financial appraisal and a production appraisal of the few main ideas that are left after the initial screening. It is important to view the range of international opportunities – different sales volume possibilities in different parts of the world, ideas that are more suitable for some parts of the world than others. In addition, the company should consider adaptation costs for individual markets and the cost of engineering adaptation for the main (or all) markets during the NPD stages.

(c) Development

Development is the longest phase of NPD and it needs to include international perspectives – in many companies, though, this can be a rather narrow, ethnocentrically-dominated activity.

Development involves many functions of the company, including research and development, production, purchasing and marketing. In programmes that are co-ordinated across several countries involving multi-cultural teams, there is a need to plan activities with great care. In most companies it is necessary to increase the speed and cost control of NPD. It is in the development stage that project management systems can assist in time and cost control.

(d) Market Testing

Market testing should be realistic and take into account market similarities and market differences.

Many companies rely on marketing research testing techniques of various kinds and some companies extend this to include test marketing. In international marketing, some testing might take place through international trade fairs. If test marketing is used, it is important to select representative and isolated markets. In this respect, Australia is sometimes used as quasi-representative of US and European markets.

(e) Commercialisation

Commercialisation needs to be co-ordinated to beat competitors into the market-place.

In past years the launch activity took place over a number of years. The present trend is to carry out co-ordinated launches in a number of countries at the same time, or in very tightly timed sequence. Such co-ordinated launch programmes require a high level of organisational capability and considerable resources.

In most markets, competitive reactions will be swift. It is, therefore, essential that the launch plan is formulated with regard to probable competitive actions. In addition, contingency plans should be developed for a number of “What if?” scenarios – for example, what if your main competitor reduces the standard price of its products by 10%? If the reactions to this are preplanned, the company can minimise the damage to the launch plan.

Project management techniques should be used to programme and control cost and time. The project should take account of the foreign exchange implications of the new product. Large multinational and transnational companies will look to balance their inflows and outflows of foreign currency, in order that their foreign exchange is limited to the net balance rather than the foreign exchange of the complete amounts of foreign currency.

Packaging

Packaging is subject to a wide variety of demands in its twin roles of protection and promotion in different country markets. In the development of new products a number of important factors need to be considered:

- Protection issues relate to climatic differences. Climate can vary from cold and dry to very hot and wet. Can the package and the product cope with those extremes? What distribution channels will be used and what modes of transport will be employed? If the product is sold through open air markets, extra protection will be required.
- Promotion issues will relate to the customer and the distribution channels used. Language changes need to be considered. Specific packaging and labelling laws will need to be adhered to precisely. In some markets, less affluent consumers will need smaller pack sizes and perhaps cheaper forms of packaging. More affluent markets are often characterised by larger pack sizes, considerable amounts of on-pack sales promotional copy and high levels of packaging sophistication. These differences make attempts to standardise packaging rather difficult.

Organisational Structures and New Product Development

As we shall see later in this study unit when we consider the product adaptation versus standardisation issue, the new international product development process would be affected by the type of organisational structure and procedures which a company has. Earlier in the course we identified a range of organisational structures and distinguished three types with different degrees of centralisation – the umbrella, macropyramid and interconglomorate organisation. According to which of these structures prevails in an organisation, we can expect to find different approaches to the new product development process.

For example, a company with a very centralised structure, such as found in the macropyramid approach, would be likely to have a very rigid new product development process with new products being developed centrally at headquarters, often for the major domestic market and then being rolled out to other parts of the world. A decentralised structure, on the other hand, will tend to give rise to more planned variants of new products. As always, the new product development programme will need to be a balance between the financial and control advantages accruing from more centralised/standardised approaches to the process, with the advantages which accrue from having new products more closely tailored to individual market needs with the resulting potential for increased sales.

Financial Implications

New product development is an essential activity, but it is also a risky and expensive one. However, it is often more risky to do nothing and then it becomes a question of managing the level of financial risk.

Companies are often attracted to markets that are growing at faster than average rates. It is probable that many companies, from different countries, will be aware of the market growth. It is usual for several companies to be going through the NPD stages hoping to be “first to market”. Not everyone will win that race. Whilst the first mover advantage can be decisive, sometimes the first companies make mistakes with their new products which the slightly slower companies can put right before they launch the product on to world markets.

The escalating costs of research and development mean that NPD costs need to be spread over a large volume of sales. In many instances the home domestic market will not be sufficiently large to absorb the large sales volume. This means that companies have to plan their NPD programmes on an

international scale. Some companies limit their NPD costs by forming joint ventures or entering into strategic alliances. In this way a company can share some of the development and commercialisation costs.

Most new products take some years before the full profit potential is reached. The product life-cycle and portfolio analyses demonstrate that companies need a balance of well-established products and new products. The established products fund the costs of developing new products and sustain them during the early, expensive years of commercialisation. If a series of launch activities take place in different countries, extra costs will have to be carried by the established products.

Increased speed in new product development has an impact on finance. A balance has to be struck between the, often, higher costs of doing things more quickly, the increased risks if decisions are taken with less reliable but faster marketing research, and the competitive benefits gained by beating competitors to the market.

New Processes

It is important to remember that companies not only compete through developing new products but also through the development of new processes. So, for example, many companies have sought to improve their competitive position through the introduction of improved manufacturing technologies and planning systems, such as just-in-time production, CAD/CAM systems, and so on. In fact, in many ways, competing through new processes is more difficult for competitors to copy than new products, and therefore can give a longer lasting competitive edge to a company.

E. PRODUCT ADAPTATION AND STANDARDISATION ISSUES

As with all the elements of the marketing mix in international marketing, the issue of adaptation versus standardisation is important. In fact, this issue is probably more important with respect to the product element of the mix than virtually any of the other elements. The reason for this is that the potential benefits of standardisation are greater in the product area than in the other areas of the marketing mix. By standardising the product, a company can gain substantial economies of scale in design, manufacturing and so on. In addition, standardising the product enables the business to achieve better control in terms of, for example, quality standards, and to present a uniform, global image through the product to the customers. On the other hand, there are pressures pushing towards the need to adapt products for different parts of the world, including, for example cultural, legal, technological and economic factors.

These forces and factors require the business to consider the adaptation versus standardisation decision with respect to a wide range of product attributes including:

- The core product
- The actual product, including functional features and attributes
- Product styling and design
- Quality
- The augmented product, including warranty, after-sales service and installation
- Packaging

Here we shall discuss the issue of standardisation versus adaptation by looking at the factors which will affect strategy in the product area of the international marketing mix and identifying broad alternative strategies which may be adopted.

Factors Favouring Product Standardisation

On balance, the trend is towards increased standardisation of the product in international markets. A number of factors are responsible for this:

(a) Economies of scale

Probably no other element of the mix offers a greater potential for cost reduction through standardisation than the product area.

As already mentioned, by standardising the product, a company can gain substantial economies of scale resulting therefore in lower costs and potentially (if appropriate) lower prices. Economies of scale through standardisation arise principally with regard to production processes. However, there are also substantial potential economies of scale in areas such as product design, research and development, and even packaging.

(b) Improved control

Standardising products offers the business a much greater degree of control over important elements such as quality, after-sales service, installation and so on. Reliability and consistency of quality is so important in today's markets that companies will seek to standardise products and components as much as possible. This also gives better control over production and facilitates lower stockholding costs.

(c) International standards

Increasingly, international standards with regard to factors such as product design, safety standards or technical features are becoming similar throughout different markets. So, for example, all food products sold in the European Union must conform to stringent, and increasingly uniform, standards with regard to aspects such as ingredients, testing and so on throughout the member states. Electrical products and computing hardware and software are increasingly produced to industry standards, often determined by the dominant producer. These standards lead to products being more and more uniform with regard to technical features, design, ingredients, and so on.

(d) Increasingly homogeneous markets and customer needs

Markets, and particularly consumer needs within these markets, are becoming increasingly homogeneous across national boundaries. Factors already mentioned, such as increased travel, improved education and developments in international communications have all served to facilitate this trend. As a result, consumers increasingly buy similar products irrespective of where they are in the world.

(e) Growth of the global company

Finally, the growth of the global company itself has helped hasten the trend towards more standardised marketing, including standardised products. For example, Pepsi Cola, Levi Strauss and IBM are all global companies trying to market their products on a similar basis in all parts of the world.

Factors Favouring Product Adaptation

Although the trend has been towards an increased standardisation of products in international markets, a number of factors serve to constrain the extent to which product standardisation can be achieved. Amongst some of the most important of these factors are the macro-environmental factors, composed of social/cultural, technological, economic, and legal/regulatory factors.

(a) Social/cultural factors

Some of the strongest forces which may require the business to adapt products for other markets are social or cultural factors. Many products simply could not be sold in some markets if they were not adapted to local needs in this respect. So, for example, many food products cannot be sold in other countries because of religious or social reasons. Even where a product is not prohibited, different usage patterns in a society may require extensive product modification due to different habits and customs. Tripe only sells in certain parts of France and Northern England even though there are no specific regulations in Europe prohibiting the sale of this product.

Other products may need modification due to different usage patterns for which there is no obvious explanation but which are still important. So, for example, the French use top-loading machines for washing, whereas most of the rest of Western Europe prefer front-loading products. Overall patterns of usage of products may differ even between geographically approximate countries – the average Frenchman makes much less use of soap products than does his UK counterpart but uses more deodorants and aftershave.

(b) Technological factors

Technological factors often require the business to adapt products for different markets. An example would be the requirement to adapt electrical products in different parts of the world because of the different voltages in use in different countries. Even in the European Union, voltages on which appliances operate are different between the member countries.

Another example would be the area of technological support for a product which may differ between countries. In some countries, skill levels and technological training may make it impossible to ensure the necessary level of technical support in terms of after-sales service and maintenance for a product. This may require the design of the product with respect to these aspects to be modified for different countries.

(c) Economic factors

Economic factors, too, may be important in requiring adaptations to products between different countries. So, for example, in lesser developed countries the business may have to modify product quality levels or the features and design of a product in order to make the product more affordable to the consumers of a particular country. In developed economies, many consumers are looking for higher quality products and the latest designs, for poor countries products may have to be de-engineered to some extent in order to market them.

(d) Legal/regulatory factors

Obviously, the business needs to adapt products to meet different regulatory and legal requirements in different markets.

One of the major problems experienced by the European Union in its attempts to move towards a single market has been the differing legal and regulatory standards for products in different member countries. Even seemingly simple products such as cheese, food colourings and chocolate have been subject to major differences between different countries with regard to

regulations concerning how they are made, the ingredients used and even what they are called. Countries differ with respect to areas such as the required safety standards for products or even how they are packaged.

These are the major factors pushing businesses towards the adaptation of products and services, but there are a number of others which will affect the decision, including:

- Topography
- Climate
- Competitors
- Company objectives and strategies
- Infrastructure
- Company organisational structure

Most of these factors are self-explanatory – for example, a clothing manufacturer will obviously need to take into account differences in climate between countries when making decisions regarding the need to adapt products. Perhaps we do need to explain, however, how company organisational structure can affect the product adaptation versus standardisation decision.

The Influence of Organisational Structure

Majaro's classification of organisational structures into umbrella, macropyramid and interconglomorate, based on the degree of centralisation/decentralisation, offers an insight into the issue of product standardisation/adaptation. So, for example, the centralised approach of a macropyramid organisational structure is likely to favour a very rigid new product development process and a much more standardised product approach. Under this organisational structure, products will be created and developed at headquarters and then commercialised into other countries if successful.

In addition to the degree of centralisation/decentralisation, the horizontal basis of structuring the organisation can also affect the degree of standardisation of products in a company. So, for example, we could identify the following implications for NPD in companies which structure their organisations by product or region, or by using a matrix organisation:

- ***Product –*** This type of organisational structure will tend to encourage greater standardisation. However, the emphasis upon the product might result in a greater realisation of differences around the world, and this could give rise to planned variations in the new product development programme in a company.
- ***Region –*** Standardisation is much less likely in organisations that are structured by region. Regional specialisation will result in regional variations being emphasised.
- ***Matrix –*** This structure is based upon the dual use of, say, functional and regional specialisation. The use of the matrix structure can result in a more harmonious balance between the errors of over-rigid standardisation and the waste and excesses of too much adaptation.

Product Adaptation Versus Standardisation Strategies

Clearly, many factors have to be considered, researched and evaluated with regard to the degree of product standardisation or adaptation and which specific aspects of the product this decision pertains to. However, a number of frameworks have been developed with a view to delineating the broad

alternative strategies available to the business with respect to international product standardisation/adaptation, and here we shall consider two such frameworks.

(a) Mesdag

Mesdag identified three NPD strategies as follows.

- ***SWYG (sell what you have got) strategies***

  As the name implies this strategy is based on simply selling the same product that we are selling in the home market. In one sense, then, we could argue that this is adopting an entirely standardised approach inasmuch as the product is not adapted for different markets. However, this is not truly a standardised approach as much as standardisation by default. Many passive and new exporters operate this strategy, often because they lack the necessary commitment and/or expertise to do anything else. Clearly, such a strategy is relatively simple for the business, but it can often be a recipe for disaster inasmuch as it is not a considered strategy as such and is essentially not marketing oriented.

- ***SWAB (sell what people actually buy) strategies***

  Essentially, this strategy involves adapting the product to meet local needs in each market. As such, it is very customer oriented, but can be costly and complex. It is essentially a strategy of differentiation.

- ***GLOB (sell the same thing globally, ignoring national frontiers) strategies***

  This, too, is a standardised approach, where products and brands are essentially the same irrespective of where they are being sold. Unlike the SWYG strategy, however, this approach to standardisation is a considered one with a marketer making a conscious planning effort to develop global strategies which enable the marketing of standardised products and brands.

(b) Keegan

A second framework for identifying alternative product adaptation or standardisation was developed by the marketing academic Warren J. Keegan, who identified five possible alternative strategies based on the extent to which a combination of product and promotional elements of the marketing mix are standardised or adapted. The five strategies identified by Keegan are as follows:

- Standardised product/standardised promotion worldwide
- Standardised product/adapted promotion
- Adapted product/standardised promotion
- Adapted product/adapted promotion
- Product invention

These five alternative strategies are largely self-explanatory with perhaps the exception of the fifth one – product invention. This strategy is used where an existing product, even if substantially adapted, could not be sold in a market. The reasons for this might be due to any one, or a combination of, factors including, for example, the cultural, economic, technological or regulatory factors discussed earlier. In this situation, the only alternative if the business is to enter the market, is to invent a new product or at least approach. A good example would be the

clockwork radio which was invented for use in countries where electricity and batteries for conventional radios were simply not available.

Obviously, which one of these alternative strategies is most appropriate will depend on the forces and factors already considered. Essentially, though, overall the marketer must determine the most cost-effective strategy for the company. Again, it should be stressed that product adaptation/standardisation decisions are amongst the most important that the marketer must consider in developing the international marketing mix.

Study Unit 12

International Pricing Policies

Contents ***Page***

INTRODUCTION

We start this study unit by concentrating on the international issues of pricing strategies. This will take account of basic pricing considerations – reference to the costs associated with the product, prices set by competitors and the influence of customers. International pricing also needs to consider economic, currency and the SLEPT factors for both countries and trading blocs. In addition, transfer pricing is important for multinational companies and the management of parallel or grey markets will also be examined.

The size and scope of international pricing considerations will be vary for companies of different size and orientation, and with their objectives. Thus, some companies will be engaged in quite modest levels of exporting whilst other, major companies will be grappling with the possibilities of global business and will be seeking to identify the extent to which pricing strategies should be part of the global view. Other pricing strategies, such as skimming and penetration pricing, related to broader company strategies will also be examined.

Finally, we look at countertrade which is particularly associated with business transactions in developing countries. Countertrade is when all or part of the payment made for the product or service is in the form of other products or services rather than cash. In this way the price value has to be calculated and traded rather than the more straightforward negotiation of a price set in a specific currency.

We will conclude the study unit by looking at specific pricing methods and export price quotations.

A. PRICING STRATEGIES

Before we look at a number of specific pricing strategies, we need to consider the factors which influence decisions on those strategies.

Considerations in Strategy Development

Pricing strategies need to be based on many of the same considerations in international markets as they are in domestic markets. This will include the costs of production and marketing, the nature of competition and the prices of competitor, and the reactions of customer demand to different pricing levels. In addition, the objectives of the company will be a significant factor.

All of these have an additional dimension arising from the nature of international business – particularly in terms of the conditions in the country itself and the nature of the market in specific countries. The use of the SLEPT and C factors can help identify particular difficulties.

(a) Company and products

What is the company position regarding the speed of profit returns? It is common for UK and US companies to need a quick payback on market entry and on new product launches, this being dictated by stock market pressures. Japanese companies, on the other hand, often have a much slower requirement for initial profits.

What is the company position regarding relative costs? Does it have cost advantages over competitors? If it does, are those cost advantages sustainable in the future? If the company has the lowest cost position in the world, it has more pricing options than a company with higher than average costs.

What are the extra costs that are incurred by marketing to other countries? The extra distribution logistics costs are one obvious area. There might also be extra marketing research costs, extra organisational costs and so on.

(b) Markets

The ability of customers to pay in different country markets needs to be investigated. What is cheap in some markets might be too expensive in other country markets. Soft drinks are an impulse buy in industrially advanced countries, but in lesser developed countries the same soft drink might be an extravagant luxury – unless the company has a different, lower pricing strategy for LDCs.

Distribution channel arrangements also vary from country to country. In some countries, a multi-layered system with its extra layers of profit margins and commissions will cause the end consumer price to be much higher than in countries in which fewer distribution channel intermediaries are necessary.

The strength of competitors and the level of aggressiveness of their pricing policies can be a major influence on long-term strategic pricing and on short-term tactical pricing. In international markets, some competitors can be global. Some of these might be using standardised pricing strategies. Others might be multinational enterprises operating different pricing strategies in different markets. Other competitors will be local ones who, in some countries, for example in Asia, will have low costs and be able to undercut most competitors on the basis of price.

(c) SLEPT and C factors

Different countries will have different rates of inflation, as we have seen in Brazil which has suffered from high rates of inflation for many years. Pricing strategies in economies with very high and fluctuating rates of inflation are very difficult to develop and implement.

Government imposed conditions, particularly price controls and varying tariffs and VAT or sales taxes also impact on pricing. The differences in these, country to country, make the standardisation of pricing very difficult.

In some situations, services such as credit, leasing arrangements or countertrade (which we shall discuss later in the study unit) might change the importance of the price as a central point in the value of the product.

Currencies also fluctuate considerably. Over the past few years the Japanese yen has increased in value against many currencies, including the US dollar. In this situation Japanese companies have had to take steps to move production away from Japan, because it has now become a very high cost country. The high cost has been influenced considerably by the rising value of the yen.

(d) Company objectives

Various company objectives may influence the suitability of different pricing strategies.

- A typical objective is the specification of a particular rate of return on capital employed, so prices would have to be calculated to achieve this return. This can cause very high prices to be charged when new products are launched that have emerged from a high cost R and D and new product development process.
- Another objective is the achievement of a particular market share. Japanese companies appear to follow an international expansion plan in which the achievement of substantial

market shares after a number of years is a key objective. If this is the case, the company will probably make big losses in the first few years after market entry.

- A further objective is early cash recovery. Companies that are starved of cash may stipulate that market entry has to be made to achieve a break-even position in the first year.
- Other objectives relate to competition. One objective might be to avoid the outbreak of a price war. Another objective might be to discourage competitors from entering a particular country market.

(e) Price escalation in the value chain

A facet of pricing in international marketing is the phenomenon of price escalation in the value chain. Compared to purely domestic marketing, there are a number of potential additional costs involved when marketing products across international boundaries, such as additional transportation and insurance costs or more intermediaries involved in the channels of distribution. There are also additional charges for elements such as export documentation and the requirement for more specialised packaging and import duties.

With a longer chain of value activities in international markets, the result is that costs and, therefore, prices are often escalated. This means that, for example, a product which is price competitive in the domestic market may be totally uncompetitive with regard to price in international markets.

In appraising the viability and potential of international markets, therefore, the business must carefully consider what the extent of price escalation is likely to be and the potential impact of this on demand. Of course, it may well be that the business can seek to minimise price escalation by cutting costs as far as possible. Alternatively, it may decide to, for example, modify the product to make it cheaper. More direct channels of distribution may also help to minimise costs and therefore price escalation.

Options in International Pricing Strategies

There are several options open to a company. These can be grouped under standardised, geocentric and adaptation pricing.

- Standardised pricing
  - as a deliberate strategy
  - relating to an ethnocentric orientation
- Geocentric pricing with local factors influencing the final price
- Adaptation pricing
  - as part of a polycentric orientation in an MNE
  - as a deliberate strategy by companies of various sizes

(a) Standardised pricing

Standardised pricing involves setting a price that is only changed by the specific costs of transporting goods to the country.

Some companies take this position as a deliberate strategy to prevent the development of ***grey*** or ***parallel markets***. Grey markets develop when a product is moved, by other companies, from

one country to another to take advantage of price differences between the two countries. The grey market often undermines the company position and that of its distribution channel intermediaries in that country market. The company suffers because the product, being sold purely on price, loses corporate and brand values and its distribution channel members. If a company uses a deliberate standardised pricing policy, there is no price differential to be exploited by potential grey marketers.

Another form of standardised pricing is that related to companies following an ethnocentric orientation. The price is the price charged in the home market plus all the extra costs that are directly associated with that order. The end effect might be broadly similar to the deliberate strategy but the reasons are quite different. One is a deliberate and explicit strategy. The other is an implicit strategy. No formal strategic planning is used in its formulation.

The weakness of the standardised pricing strategy approach is that it fails to take account of customer, market and competition differences in different country markets.

(b) Geocentric pricing

Geocentric pricing aims to develop a pricing strategy that, taking all country markets, will be coherent. The coherence might be based upon competition policy, it might be calculated to minimise the possibility of grey markets developing, or it might be based on different world region groupings.

Geocentric pricing is concerned with developing a broad and consistent strategy within which different country managements can make appropriate adjustments.

(c) Adaptation pricing

Adaptation pricing can be part of the typical MNE with its polycentric orientation. If this is the case, each subsidiary will calculate its price based on factors that are adapted to the host country.

Another version of adaptation pricing can be followed by companies other than MNEs. These companies would adapt the price according to their understanding of opportunity, market demand, distribution channel influences and competitive pressures.

Transfer Pricing

When a company expands into operations in other countries, it becomes involved in selling semi-finished or finished products from one subsidiary to another. The price at which goods are exchanged internally is called the ***transfer price***.

Transfer pricing is an issue both for individual subsidiaries, because the level of the transfer price affects the profits made by the subsidiary, and for host governments, because the level of profits made by the MNE subsidiaries in their own country influences the amount of tax receipts for the country concerned. For LDCs, tax revenue from MNEs can have a significant effect on total national income.

There are great opportunities to discuss and dispute transfer prices. The usual approach is to transfer at cost plus some element for profit contribution. The amount of the profit contribution can be changed to give the MNE the best overall international position, both in terms of minimising tax returns and in terms of its international competitive position.

Skimming and Penetration Pricing

In addition to the international pricing strategies of standardised, geocentric and adaptation pricing, companies can also use skimming or penetration pricing.

(a) Market skimming

In this strategy the company sets a high price when it enters the market to try to segment the market on the basis of price. This approach can be effective in gaining a fast recovery of cash to pay for high new product development costs, providing the market can be segmented by price. To do this, the product in question must be special in some way, for example, it might have patent protection that prevents competitors from copying the product. In countries in which intellectual property rights are not protected, it might be impossible to develop a market-skimming strategy because counterfeit competition would erode the market segment too quickly.

A company using market-skimming can gradually drop the price, over time, to exploit other market segments with a different price responsiveness to the initial market segment.

However, the high price set in this strategy can also encourage competitors to enter the market, lured by high profits.

(b) Market penetration

This pricing strategy is designed to build sales volume quickly. It builds sales, market share and experience. It is a strategy that has been adopted by many Japanese companies in consumer durable and industrial durable markets. The customer response to market-penetration pricing can be to build more sales demand. The effect, therefore, of this strategy can be to allow further price cuts because the new cost structures, resulting from the high sales levels, permit further reductions in price.

An attraction of the market-penetration pricing strategy is that the low price discourages competitors. If competitors are deterred for long enough, the company can build a powerful market-share position - one from which it can only be dislodged with difficulty. Its strengths are in its customer franchise and in its low cost position based on a strong relative market-share position.

Both strategies are medium term – aiming to last for at least one year or longer. Market skimming can be the shorter of the two strategies. The reason for this is that the strategy is open to more competitive reaction. In addition, the company might cascade down through a series of market segments as it reaches the extent of the buying potential at a particular price level. Market-penetration strategies are set up as longer-term strategies. The objective is to build a strong market-share position and a low cost of production, which are strong defendable positions.

B. COUNTERTRADE

Countertrade is a general term used to describe transactions in which all or part of the payment is made in kind rather than in money. Instead of using money as a unit of account, one product is swapped for another – for example, machine tools might be countertraded for wire.

Note that, although money does not necessarily change hands as part of countertrade, price will still be a feature of the transaction. This is because the relative values of the products traded need to be established and they also need to be sold, at some point, for cash. Thus, the market value of the goods – through the normal mechanisms of supply and demand – will continue to be important.

Reasons for Countertrade

There are a number of reasons for engaging in countertrade and it offers attractions to various interests in the arena of international business:

- It is promoted by governments as a means to encourage companies to buy products or services from their country. In this way, convertible currency (or hard currency) will be conserved and the balance of trade will have more exports to offset some or all of the imports.
- Companies will use countertrading as a means of negotiating the sales of products or services. The use of countertrade influences the pricing approach taken by the company. In some situations the money price may completely disappear – the transaction will be based on a calculation of the value of the different elements in the countertrade. In other situations, a money price will exist, but the level of the price will be influenced by various combinations of negotiated countertrade deal.
- It is also attractive to companies as a way of avoiding issues directly connected with currency exchange. There are various risks associated with fluctuations in exchange rates which may mean that value may be lost in changing currencies received or payable as a result of international transactions. We shall examine this in detail later in the course, but here we can note that countertrading, by not using money to effect the transaction, can be an effective means of removing these risks.
- Countertrading is also used in selling to buyers in developing countries as a means of minimising currency difficulties and as a way to finance the transaction on behalf of the buyer. It is particularly related to the sale of military equipment and capital equipment, but may be used in the sale of many different types of product and service.
- For buyers in countries in which the availability of convertible currency is limited, the ability to establish an exchange value through offering other goods or services is a useful method of pricing.

Types of Countertrade

There are a number of ways in which countertrade deals may be effected.

(a) Barter

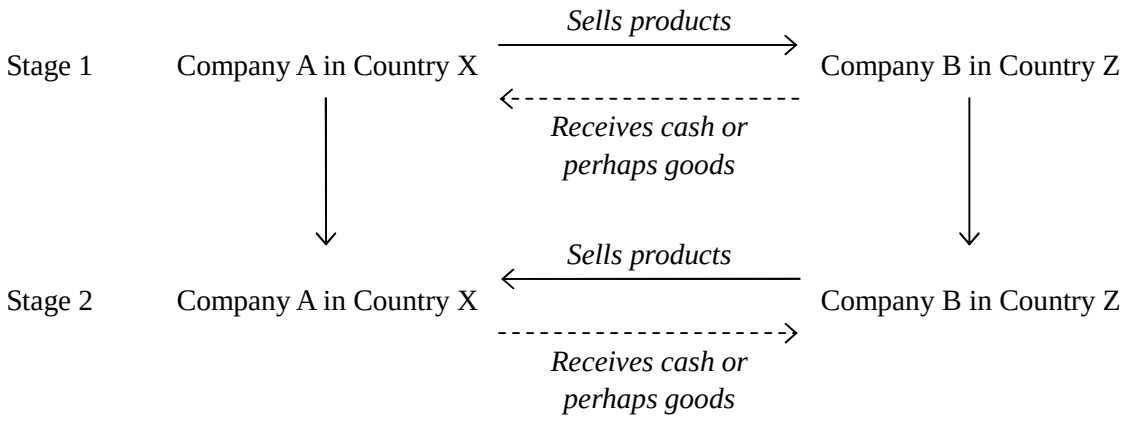
Through history, goods have been bartered and, at its simplest, countertrade will be a barter deal. This happens when one product is exchanged for another product without the use of a price calculated in money. One product is valued in relation to the other product.

(b) Parallel barter

Parallel barter takes place when the deal is made in two distinct phases. In addition, the deal is quite likely to be made with the use of currency.

The parallel barter is a counterpurchase or a reciprocal purchase. The contract will stipulate that the first purchase is dependent upon the subsequent purchase of other products. The process is illustrated in figure 12.1.

Figure 12.1: Parallel barter



The Stage 2 deal is often dependent upon the Stage 1 deal. Sometimes the reciprocal purchase is to the same value as that at the Stage 1 level. More frequently there will be differences in the value of the two stages of the parallel barter.

(c) Buy-back

This type of countertrade is associated with the sale of capital equipment. It is a way in which the price of the product is linked with sale back to the exporter of some or all of the output of the capital equipment. For example, a company might sell a cement factory to a buyer in a developing country. As part of the price negotiations, the exporting company will agree to take certain amounts of cement over so many years. The advantage to the buyer is that part of the output of the cement plant over so many years will have a guaranteed sale. To the exporter the buy-back is a way of rearranging the value of the price.

The process is illustrated in Figure 12.2.

Figure 12.2: Buy-back arrangement

	Value to Exporter		**Value to Buyer**
Main transactions	Price of the cement factory	→	Partly or completely paid in currency
	Cement for resale (or, possibly, use)	←	Sales of cement produced
Subsequent transactions to realise the value in the "bought back" cement	Sale of cement to another separate company or a third-party specialist in selling countertrade in general or a specialist in the sale of cement		

(d) Offset deals

Offset deals are particularly associated with transactions in which governments are involved. As such, they are likely to be concerned with expensive items of military equipment or major civil engineering contracts.

As part of the overall negotiation, the exporter agrees to arrangements in which part of the contract is produced in the local economy. For example, some of the components might be sourced locally, the assembly might take place locally or commitments about the local labour content of the civil engineering contract might be made. Offset deals are, therefore, linked to the final price. Without the offset arrangements, the local government will not agree to pay the price of the main contract.

(e) Switch trading

This approach is one in which third-party companies or trading houses are used by the exporter to trade the goods received, in order to release the value in the countertraded goods. For a fee, the trading houses will arrange the sale of the goods taken in exchange for the exported goods. For the exporter, the trading house is useful because the risks of receiving unfamiliar goods are taken away. However, the fees taken by the trading house reduce the profits that can be made from the countertrade.

Countertrade and the Exporter

In some countries and with some customers, countertrade might be the only way in which a sale can be made. These deals are most likely in LDCs, but reciprocal, buy-back and offset deals can happen in the sale of capital equipment and military equipment in many different situations.

Countertrade deals force companies to trade in ways in which they are not particularly efficient. The core expertise of the company will be in the products or services in which the company is a specialist. The receipt of other, often totally unrelated, goods faces the company with the need to extract the best value from the unfamiliar goods. The company either needs to develop in-house expertise in handling countertrade deals, or it needs to use third-party companies who specialise in arranging countertrade deals. The problem with using the specialist trader is the fee charged, which will reduce the available profit margin to the exporter.

C. SPECIFIC PRICING METHODS

You are doubtless already aware of the major alternative methods of setting prices. In fact, essentially these methods do not differ when considering international business, even though there are a number of additional considerations and complexities to be taken into account when pricing across national boundaries. To remind you, however, of the three major alternative methods of setting prices, we have outlined each of these below, together with the relative advantages and disadvantages of each.

Cost-Based Methods

As the term implies, cost-based methods set prices primarily using information on costs. There are several alternatives with regard to setting specific cost-based prices, but the major ones are as follows.

(a) Full cost/cost-plus pricing

This is one of the simplest methods of pricing and usually involves adding a predetermined percentage based on required margin levels to the total costs of producing and marketing a product. Proponents of this approach argue that it is simple to administer and ensures that prices cover all costs.

However, it effectively ignores demand and can therefore result in lost marketing opportunities because it is not customer-oriented enough. Given the increased costs which are often incurred in marketing a product across national boundaries (discussed earlier as “cost escalation”), cost-plus pricing can also render a product totally price-uncompetitive in an export market.

(b) Marginal cost pricing

With marginal cost pricing, although costs are still the major basis for setting prices, a distinction is made between variable and fixed costs in order to assess whether or not a contribution can be earned. Under this approach, sometimes the business may set prices at less than full cost, provided some contribution to fixed costs is being earned. As such, it is much more flexible than the full cost method and can be used where a business is trying to penetrate an export market for the first time based on lower prices.

Competitor-Based Methods

Again, as the term implies, competitor-based pricing methods involve using competition as a benchmark for fixing prices. Prices set can be more or less than other competitors in the market, but often a competitor-based approach will use the industry price leader as a reference point for setting prices.

Competitor-based methods are useful in that they acknowledge the importance of competitive factors in the pricing decision and enable a company to consider how the company can differentiate its offer in the competitive range. They may also be used as a way of creating barriers to prevent competitive entry to a company's markets.

However, competitor-based pricing may result in a company ignoring differences between its own and competitors' cost structures, resources and marketing objectives and strategies.

Demand/Market-Based Methods

Demand-based approaches to pricing are the most marketing-oriented methods of pricing because they are customer oriented. Essentially, this approach sets prices on the basis of the customer's willingness and ability to pay and the market structure prevailing. Obviously, this requires a detailed understanding of customer demand schedules and may require market research.

Both market skimming and market penetration pricing are examples of demand/market-based pricing and serve to illustrate how this approach to setting prices reflects a much wider range of demand and customer and competitor considerations than do the other approaches to pricing.

D. QUOTING EXPORT PRICES – INCOTERMS

As in domestic markets, interested customers will often ask a supplier for a price quotation. Unlike domestic markets, however, export price quotations take on an added significance in that different methods of quoting have different legal and cost implications with regard to the responsibilities of the buyer and seller.

Export sales prices can be quoted in different ways according to the different responsibilities to be borne by the supplier and the customer with regard to the transfer of ownership, payment of freight, and responsibility for such areas as insurance, documentation, export duties and taxes. So, for example, when a customer asks for a price quote, the supplier may quote the price which involves the goods being delivered to the customer's warehouses with the supplier being responsible for all freight, insurance costs, and any tariffs and duties up to the point when the goods are delivered to the customer's warehouse.

At the other extreme, a supplier's price quote may be only on an ex-factory basis, which means that the customer will be responsible for all insurance, documentation and transport costs. Clearly, these are very different price quotes, so the customer and supplier must understand and agree exactly what each party's liabilities and responsibilities are in terms of the quote.

Because of the importance of price quotes in international markets, and in particular the need for both buyer and seller to understand the trade terms encompassed by a particular price quote, the International Chamber of Commerce (ICC) has established a set of internationally recognised trade terms to cover international trade and price quotations. These are known as "***Incoterms***".

Incoterms are essential in international trade because they reduce the uncertainties connected with the buyers' and sellers' liabilities and responsibilities. Using Incoterms means that the same terms can be used around the world. In the case of a dispute about a particular order and its delivery, the dispute can be minimised because Incoterms provide a standard definition of trade terms.

With regard to price quotations in international markets, the following Incoterms are used according to which stage export prices are being quoted:

- **Ex** – point of origin. This price quote involves the supplier transferring the product and its title at a specified point of origin and is often based on an ex-works price (EXW).
- **FOB** – free on board. This is where the customer is provided with additional services (such as logistics).
- **FAS** – free alongside. This is where the supplier is responsible for delivering the product to the purchaser's shipped harbour.
- **C & F** – cost and freight.
- **CIF** – cost, insurance and freight.
- **DDP** – direct destination point. This is where the supplier takes responsibility for all the costs associated with delivering the item(s) to the destination specified by the purchaser.

Needless to say, generally speaking, customers would prefer the supplier to shoulder as much of the liability and costs as possible, and would therefore prefer a price quote based on CIF or DDP. On the other hand, of course, a supplier can quote a lower price where liabilities and costs are the responsibility of the customer at an earlier stage of the delivery process, and so will often prefer to quote an Ex, FOB or FAS price. Whichever approach is used, however, it is important to understand that the different Incoterms are legal trade terms and therefore must be agreed and understood by both parties.

As we can see, there are very many different Incoterms, but unless you are directly involved in export administration, there is probably no need for you to know all of these in great detail. However, we will consider three of the most commonly used Incoterms in agreeing trade terms and quoting prices as follows:

Ex-Works (EXW)

As already suggested, this method of quoting prices and trade terms implies the most basic of the levels of service that an exporter could provide for a customer. Under this contract, the exporter makes the goods available at his premises.

This is obviously not a very customer-friendly approach, but it does provide the customer with the opportunity to buy the goods at the lowest possible price. Some customers might prefer this arrangement.

The benefits of EXW will be strongest for customers who are knowledgeable about export distribution logistics and procedures and those that are seeking to reduce the amounts of foreign currency required to finance the transaction.

Free on Board (FOB)

FOB price quotes and contracts provide the customer with extra services. Under this contract the exporter arranges and pays for all the logistics services involved in moving the product from the ex-works position to a ship in a named port.

The customer benefits from the extra services which the exporter can probably handle more efficiently. The exporter, after all, should be familiar with the local domestic distribution facilities, whereas customers from other countries will often lack such local knowledge. The customer may also lack buying power compared to the supplier with regard to the purchase of local logistics services. The customer can benefit from FOB terms by specifying the customer's own national carrier and by using national suppliers of other logistics services (such as insurance). In this way, the customer can reduce the foreign currency requirements of the order.

An FOB contract steers a middle ground between the lower cost ex-works type contracts and the higher cost CIF and DDP contracts. Thus, a customer might insist on an FOB price quote because the level of service provided would be higher than that offered with an ex-works price but would not be as expensive as a CIF price

Cost, Insurance and Freight (CIF)

CIF terms provide the customer with a much higher level of service than EXW or FOB terms. CIF price quotes and contracts provide the customer with all the costs arranged and risks paid for by the exporter to a specified port of destination in the customer's own country. The CIF contract can enable efficient exporters to use exporting services to contribute to product profitability.

The CIF contract is also a way in which the exporter can provide a higher level of service to the customer. Clearly these customer advantages of the CIF contract need to be balanced against the inevitably higher prices to the customer of such a quote.

Study Unit 13

International Promotion Policy

Contents ***Page***

INTRODUCTION

In this study unit we will examine the management of the marketing communications elements of the marketing mix. Once again, we shall be looking at the additional and special complexities which arise in planning and implementing this element of the marketing mix in international markets.

Marketing communications conventionally covers selling, advertising, public relations and sales promotion but more recently includes direct marketing and marketing communications using the Internet (often referred to as "cyberspace" advertising). It is becoming increasingly apparent that companies must view marketing communications in an integrated and complete way, something which is doubly difficult to achieve when planning marketing communications across national boundaries. We will look at the availability of the different marketing communications and the constraints that prevent their use in certain country markets. We will also consider the suitability of different marketing communications strategies. Again we will stress that suitability depends on the specific context in which the strategy needs to be implemented. We will finish this study unit by pointing out some specific features that influence the selection of agencies and consultancies in marketing communications.

A. THE CONTEXT OF INTERNATIONAL MARKETING COMMUNICATIONS

The key differences between domestic and international marketing communications lie in the availability of different media and the cultural norms and legal rules applying in a particular country. Before considering in detail the ways in these influence marketing communications, it will be useful to consider the internal context of the general communications process.

The International Communications Process

The basic process may be expressed as follows.

Figure 13.1: The communications process

Encoding process	→	**Message channel**	→	**Decoding process**
Message sender determines message and presents it in the language and the cultural context of the intended message receivers		*(e.g. salespeople and the media)*		Message receiver has to interpret the message from the information received

A number of difficulties arise in this process when we consider the international context.

The main ones relate to the lack of a common understanding between the message sender and the message receiver. This results in encoding problems and decoding problems. Encoding problems centre upon the co-ordination of extra salespeople, agencies and consultancies in the message creation and transmission process and the difficulties in translating messages into different languages. Decoding problems result primarily from differences in the cultural context of the message receiver compared with the message sender. A number of factors here can result in misinterpretation of the message. In addition, the high context/low context culture gap and the simple need to translate between different languages can cause problems.

Encoding/decoding problems may be compounded by different conditions applying to the channel in different countries. We discuss the issue of availability below, but other issues arise through the level of competitive activity and hence the amount of competing and conflicting information provided in a country.

Availability

The basic resources used for marketing communications – information, sales people and processes, and the mass media – will vary in their availability through the international arena. The effect will be felt differently in the different elements used.

(a) Personal selling

The salesforce will be influenced by the decisions taken at the market-entry stage. If the company decided to use agents or distributors, this will reduce the direct control that the company has over personal selling. If the company uses its own salesforce, the availability of this will be limited by the normal commercial decisions about how many salespeople are to be used and how much time they can spend in each country market.

(b) Advertising

Whilst the advertising media used for used for marketing communications – press, television, cinema, radio, outdoor and poster – will be available in virtually every country market, the extent to which they reach target audiences and, thus, their relative importance will differ from country to country. However, the constraints applying to what can be said and how it may be said are of more significance in this area.

(c) Sales promotion

Here, the issues will be similar to advertising. However, in the international context, advance planning is crucial in order to take advantage of opportunities that become available. For example, some international trade fairs and exhibitions are only held every two years and floor space is limited, which means that companies need to book in advance to secure space in the more important ones.

(d) Public relations

Again, since the media used will be the same as those used for advertising, general availability will not be a problem, but the context of social, cultural and legal applying in a particular country can be a significant constraint.

(e) Direct marketing

The issue here relates primarily to the availability or otherwise of appropriate databases. In some countries the databases on which effective direct marketing is so reliant simply do not exist. Another availability problem for this particular marketing communications tool relates to the effectiveness and efficiency or otherwise of the postal system itself, which obviously varies from country to country.

(f) The Internet

Differential access to, and hence use of, the Internet is the key factor here. Obviously, the first requirement here is access to a suitable PC and the appropriate software. PC ownership differs considerably still between different parts of the world with the highest incidence of ownership being in the United States. In addition, there are differences in costs of actually accessing the Internet. So, for example, compared to the United Kingdom, where telephone call rates to

access the Internet are still relatively high, in the United States where E-commerce is most developed, telephone charges for accessing the Net are amongst the lowest in the world.

Constraints

The factors which constrain the development of marketing communications are primarily social and cultural, although the legal rules applying in different countries can be significant. Again the way in which they apply will vary with the different forms of communication.

These constraints are generally far more important to marketing communications than the factors affecting availability. It is rare for an element of marketing communications to be completely unavailable. It is much more likely that what is available is constrained by country rules and regulations, by cost, by coverage and by the qualitative differences in the persuasiveness that can be obtained using different methods.

(a) Advertising

The main constraints on advertising arise in the following areas.

- ***Legal and voluntary controls***

  Different countries have different rules and regulations about what advertising messages can be transmitted. Control of advertising is usually strongest for TV advertising and is usually restrictive for products such as tobacco and alcoholic beverages. These and other differences cause constraints upon the ability of companies to develop standardised advertising.

- ***Different audience levels***

  There are considerable variations in the potential audience for different forms of media in different countries – levels of readership for different forms of print media, and the size of viewer and listener audiences vary widely. The national press is particularly strong in the UK and it is possible to cover most markets through a few titles in the press. In many other countries, the press is weak in terms of national readership levels, even though it is widely available, but the regional press is often strong. In many developing countries the ownership of televisions is quite low which means that it has a limited coverage of the mass market. However, it is important to use media research information because in some countries low ownership can be compensated for by multiple household viewing of television sets or by communal viewing in places such as bars.

- ***Different coverage possibilities***

  In some countries, such as Germany, the amount of television time available for transmitting advertisements may be constrained by a specified number of minutes per hour allowed for advertising. If this happens in a country, then the amount of advertising on TV will be limited, and the other advertising media will be increased to compensate for the TV weakness.

- ***Different costs***

  The cost of advertising is usually measured on the basis of cost per 1,000 people reached. The cost is influenced by the price of advertising space in the various media and the number of people who are in the potential market of the media exposure. Differences in the pricing of advertising space will clearly change the overall cost. Equally, though, if the media prices remain the same but fewer people read a particular newspaper or listen to a radio station then the cost per 1,000 will increase. Because media prices and media

audiences vary from country to country, the choice of advertising media can be constrained because of a high cost per 1,000 in some country markets.

(b) Sales promotion

This will be constrained primarily by legal and voluntary control differences and by differences in what is acceptable to members of the distribution channel in different countries.

Different countries restrict different types of sales promotions in different ways and these can even influence the market for certain products and services. For example, competitions are restricted in various ways in most countries – usually some skill element will be required – and whilst coupons are permitted in many markets, but they are not in some (such as Germany and Austria).

The strength of retailers in some countries, particularly in the industrially advanced countries, provides a powerful constraint in terms of what they will accept. The more powerful the retailers become, the more their particular demands for tailored promotions and specific types of promotion will be imposed upon manufacturers.

(c) Public relations

In public relations there are considerable constraints caused by the lack of knowledge of the media, the journalists employed by the media and the various publics (for example, politicians) in different countries. This means that public relations is frequently localised to particular countries because of the limitations imposed by the detailed and up-to-date knowledge required to be successful in public relations.

(d) Direct marketing

In many countries various aspects of direct marketing are covered by legislation and the international business must be familiar with the relevant rules and regulations which apply. So, for example, access to, and use of, databases are often constrained by legal factors and voluntary codes of practice. There are also constraints with regard to the content and use of unsolicited telephone and direct mail campaigns.

(e) Cyberspace communications

To the concern of at least some, marketing communications using the Internet are, currently, remarkably free of constraints. In part, this is because of the relative newness of these so-called cyberspace communications, but also because they are proving difficult to regulate and control. However, in using these tools of modern marketing communication, the business must be careful not to violate regulatory or social and ethical customs which would normally pertain in a particular country. So, for example, it would be unwise, say, to advertise alcoholic products through the Internet in countries where alcoholic consumption is prohibited. Perhaps the biggest concern at the moment with regard to cyberspace communications and controls, or rather the lack of them, relates to the promotion of pornography.

B. MARKETING COMMUNICATIONS STRATEGIES

Developing suitable campaigns using marketing communications is a major strategic demand. Suitability has to be justified in the context of the company and the international marketing environment. The diversity of country markets and the constraints and opportunities that exist within them give rise to the need to develop different solutions – for example, taking account of cultural and linguistic differences, and using an appropriate mix of communications in light of the availability and

constraints applying. These solutions must also take account of cost pressures and the resources that the company has to support its marketing communications.

As we have seen before, a major strategic decision revolves around the issues of standardisation and adaptation.

Standardisation and Adaptation

It is difficult to standardise most elements of marketing communications to any great extent. Personal selling, direct marketing, public relations and sales promotion all interface very closely with the country and its culture. The main opportunities for standardisation lie in common social and cultural elements between countries and even globally. Thus, it is possible to standardise some sales promotions through the linkage with major world sporting events, and public relations activities can adopt a common approach to, say, political lobbying or crisis management throughout the company's facilities around the world.

The greatest possibilities for standardisation arise in advertising. The main reasons for this are as follows.

- **To save money**

  The standardisation of advertising reduces the associated production costs. To take an example, a company such as Levi might spend several million pounds to produce one TV commercial. This commercial, with minor adaptations for language, can be used on a worldwide basis. If the company, on the other hand, produces a TV commercial for each of its major markets, say 20 markets at a cost of £500,000 per commercial, the total production cost will be far higher. The end effect, with 20 different commercials produced at low cost with less technical sophistication, is likely to have less impact in each country whilst at the same time being more expensive in total for Levi.

- **To present the same image**

  In the Levi example it enables the company to develop a standard advertising message and promote the concept of a global brand. This can be very valuable if buying motivations are similar in different countries.

- **To communicate with a geographically mobile market**

  If consumers move from one country to another, it is important that message confusion does not spoil sales because of conflicting and confusing messages from one country to another.

- **To concentrate on one big excellent idea**

  There are few excellent creative ideas. If such an idea is developed and if it has transferability across country markets, there is great commercial value in exploiting this idea to the full.

It is easier to see how marketing communications that are adapted to each market will gain better returns than standardised communications. The locally adapted or specially prepared country approach has a better chance than the standardised approach to be appropriate for the local market. In particular, marketing communications that are specifically prepared for a country can be made to have a high degree of suitability through attention to the detailed requirements of:

- Customer benefits and market segments
- The distribution channel
- The needs of the salesforce
- The tactical strategy for the product in its local competitive environment.

Table 13.1 shows the potential appropriateness of the three main positions in respect of standardisation/adaptation.

Table 13.1: Degree of appropriateness for local country

Form of marketing communications	Appropriateness
Specifically prepared for the country	Highest
Prepared centrally but adapted for the country	Can be high, but depends on whether the main standardised approach is appropriate to the requirement of the country
Standardised with minimal adaptation and prepared centrally	This can work very well for developing familiarity, particularly for global brands, but risks the "lowest common denominator effect" with bland communications that lack distinctiveness in any one market

Company Factors

Any strategy for marketing communications must take account of the resources of a company, its objectives and its target markets. Thus, any campaign must be carefully planned to cover the target market, with an appropriate creative message and with sufficient opportunities to cause people to act in the ways that enable the achievement of organisational objectives (usually sales revenue or profits). It is also important to match the costs of marketing communications with the required and forecast returns of sales and profits.

Note that it is not the case that all companies involved in international businesses marketing will necessarily always have the resources to pay for, or even need, large mass-market campaigns. Such expensive approaches (particularly in respect of the production costs for TV commercials) are only appropriate if the company has the resources and can use the right mass media in an appropriate way to reach its mass target market in an efficient way.

Companies marketing business products do not usually use mass media campaigns. Their campaigns are targeted to specific business markets and the associated decision-making units (DMUs) within the buyer company. The most likely approaches are specialised business publications, trade fairs and exhibitions, print through brochures and technical data sheets (in the appropriate languages) and direct mail. Sales promotion and public relations can be used in specialised ways.

C. USING AGENCIES AND CONSULTANCIES

For many companies, marketing communications are a key means by which their products and services can be differentiated from their competitors'. In particular, they need to develop communications which are appropriate both to the product and company image, and to the needs of customers in the particular market or markets served. It is seldom the case that, apart from the very large or the very small company, few will have the in-house knowledge and skills to bring to bear on this. As a result, there are a great many agencies and consultancies operating in the fields of marketing communications which offer specialist expertise.

In the international arena, local agencies are able to offer detailed local knowledge of country conditions – in particular, the local media, buyer behaviour and cultural issues. They should, then, be able to develop better, more appropriate campaigns for their country market. The problems for the client relate to the co-ordination of many different local agencies, the difficulties of communicating with them, the likelihood of different campaigns without a uniform message, and extra cost.

There are many different ways in which companies can use agencies in their international marketing. The precise arrangements should be determined by the contribution that the agencies and consultancies can make and the costs and benefits that relate to the different combinations and arrangements.

Benefits of Using Agencies

The use of agencies and consultancies was examined when we looked at external resources earlier in the course. From this you will recall that the benefits of agencies are as follows:

- **Financial**

  They can provide savings through paying for services and staff only as and when they are needed, rather than a company having a permanent commitment to maintain the necessary functions in-house.

- **Specialist knowledge**

  This is particularly important when we bear in mind the range of different types of specialist knowledge in international marketing.

- **Creative input**

  Companies rarely employ people for their creative talents, although this is a useful adjunct to most marketing and business activities. Agencies and consultancies can be used to find good creative ideas in advertising, public relations and sales promotions.

- **External perspective**

  This will be particularly helpful for international businesses. Agencies offer a way in which cultural differences can be handled and the customer perspective in each country can be applied, although it may result in campaigns that are too localised. The company needs to find a balance between extensive localisation and a “blind”, ethnocentric extension of its home country marketing communications or a bland geocentric standardisation in which the communication does not offend, but neither does it work.

Selection of Agencies

The selection of agencies and consultancies should be carried out in a systematic way.

Initially, the need for, and extent of the use of, external resources needs to be established through a careful consideration of overall marketing objectives:

- Establish whether marketing communications should be handled in-house or whether agencies and consultancies will be used.
- Establish the balance that is desired between standardisation and adaptation.
- Establish the geographic boundaries of the international communications – which countries should be covered, which are the most important markets and which will be important in the future?

- Establish the balance required in the communications mix – so, if agencies are to be used, are agencies required with particular expertise in advertising, sales promotion or public relations, and will they understand the requirements of the salesforce?
- Establish the budget for the total marketing communications – and this may be factor in attracting the right type of agencies and consultancies.
- Consider whether all the needs can be met by one agency or several, with different expertise will be required.

In selecting particular agencies or consultancies to meet the defined needs, the following process identifies the key stages and concerns.

(a) Initial screening

This should aim to identify a small number of agencies who should be capable of undertaking the work. It needs to be based on a list of criteria which can be used to assess whether an agency is broadly suitable or whether it is unsuitable. The criteria should include:

- Experience in the appropriate international markets.
- Experience in the type of product or service.
- Experience in handling and co-ordinating international standardised campaigns.
- Experience in the appropriate media and elements of marketing communications.
- Ease of communication between the client company and the agency.
- Degree of favourable testimonial support from other clients, etc.
- Whether the agency has competing or conflicting accounts.
- A review of their marketing communications output.

It is probable that the company will be able to carry out this initial screening much more effectively in its home market and its major international markets than it will on a completely comprehensive worldwide basis.

(b) Detailed screening

The next stage is fine or detailed screening to select the best two or three agencies who will then be given a precise brief and asked to prepare marketing communications solutions to the problems posed in the brief. This detailed screening will be undertaken by a more thorough assessment of the shortlist of agencies, using the criteria list, augmented by meeting(s).

(c) Final selection

The client will select the preferred agency based upon the quality of the presentation and the solutions proposed, the quality of the people (this is a service business) at the agency, and the price for the agency's services. The importance of international marketing communications for the company will be a strong influence upon the amount of time that the company will spend on this selection process.

Client-Agency Arrangements

The range of possibilities for the use of agencies and consultancies is almost endless. Figure 13.3 shows the main arrangements.

Figure 4.3: The Main Possible Arrangements to Use Agencies and Consultancies

(a)	Client	⟷	One global marketing communications company
(b)	Client	⟷	One global advertising agency One global public relations agency One global sales promotion agency
(c)	Client	⟷	As (b) but agencies operate at a trading bloc/world region level
(d)	Client	⟷	As (b) but agencies operate at a country level
(e)	Client	⟷	As (d) but using a local national agency which has a network arrangement in each country. Therefore the agency handles the co-ordination problems rather than the client

Study Unit 14

International Distribution and Logistics

Contents ***Page***

INTRODUCTION

In this study unit we will concentrate upon issues of distribution in international business.

We start by looking at distribution channels and consider the different roles that the participants undertake within the channel. Having identified the roles, we will review the varying expectations of channel members and their performance. It is important to note that distribution channel decisions have important long-term influences on the other elements of the marketing mix.

The second part of the unit is concerned with distribution logistics. This covers all those activities in moving and facilitating the movement of products from the production point to the customer. Here, we start by exploring why distribution has become more important as part of the total product and how distribution logistics can be used as a marketing tool to enhance customer value. We then consider briefly the total cost concept and the different modes of transport.

A. DISTRIBUTION CHANNELS

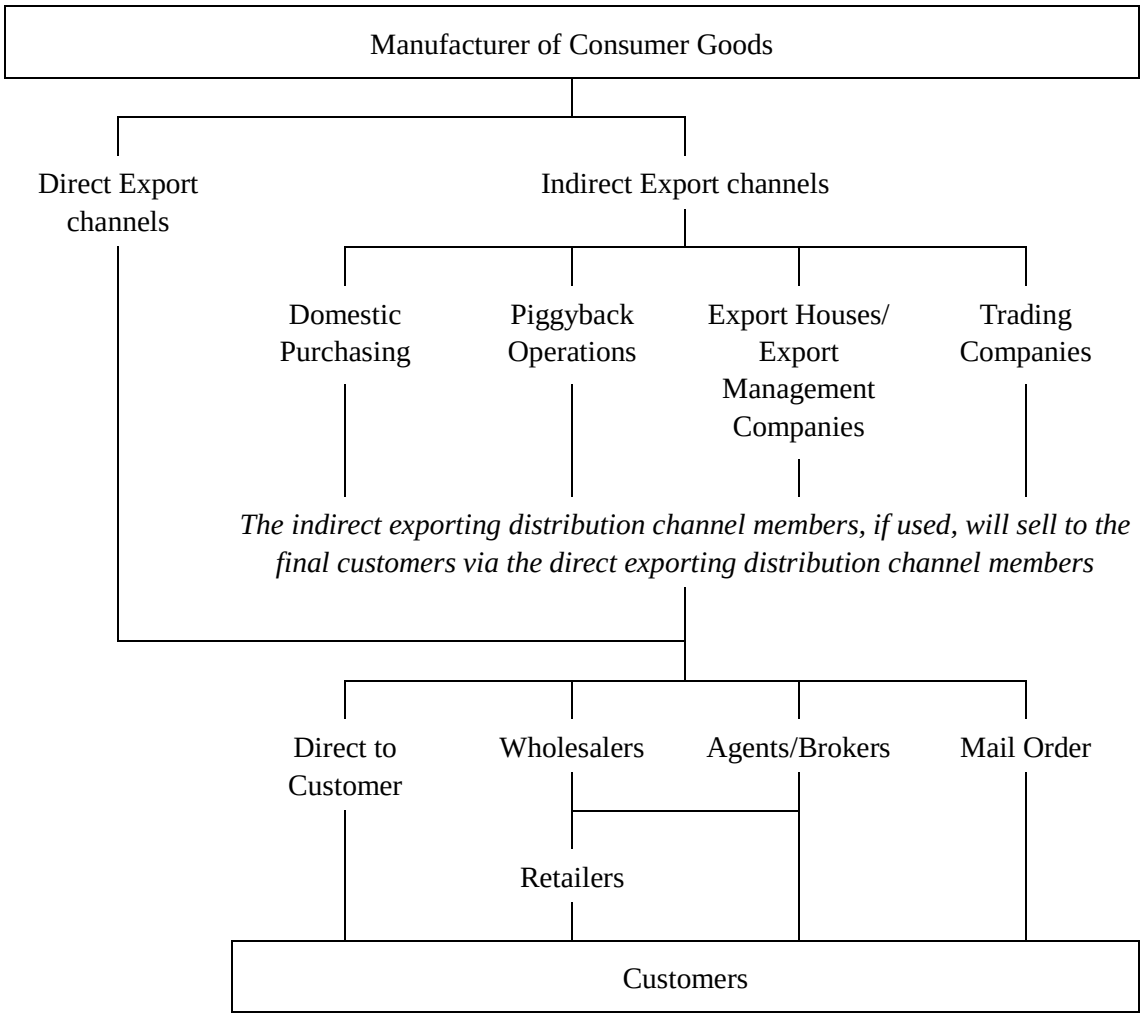
The international distribution channels for consumer and business goods show a number of similarities, and we have considered some of the channels in our previous discussion of market entry routes. In both, there is a choice between direct and indirect export channels:

- indirect exporting is where distribution is undertaken by distribution channel members based in the home country;
- direct exporting uses distribution channel members based abroad, usually in the country market itself. This invariably involves the use of intermediaries, although direct contact with customers is an important aspect for business goods.

Indirect and Direct Export Channels

We can illustrate the typical pattern of the distribution channel arrangements for both indirect and direct exporting by considering them in relation to consumer goods. This is set out in Figure 14.1.

Figure 14.1: Distribution channels for consumer goods



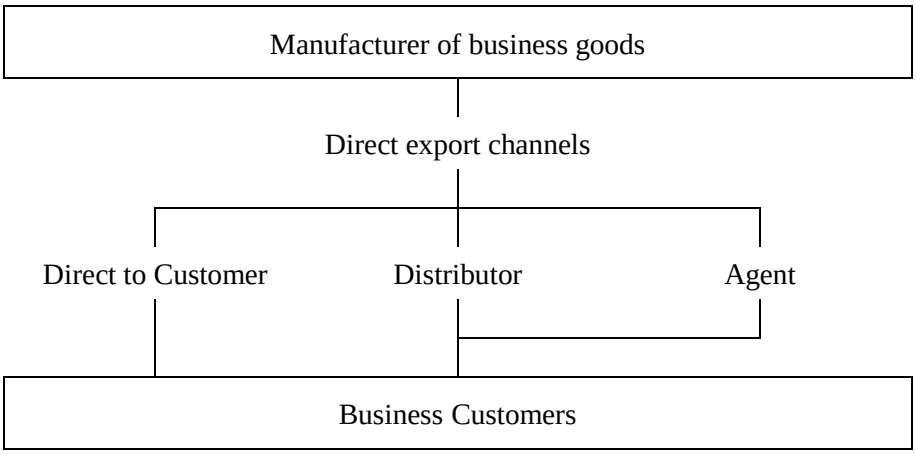
The direct channel to the customer is not very important. The main routes to the final customer are through wholesalers and retailers and also through mail order.

In business goods, the same indirect exporting channel members can be used – domestic purchasing, piggyback operations, export houses or export management companies and trading companies. However, the direct exporting channel is usually of far greater importance in providing a direct route to the business buyer and the using local agents and distributors.

Business buyers buy in larger quantities than consumer buyers. The volume of sales may well be such that the costs of selling direct to the customer can be covered, but the manufacturer, in selling direct, has to cover all the costs from the one order. An agent, retailer or distributor will be selling a number of different products and can, therefore, share the selling costs across a number of companies. A second significant point is that the business buyer will usually want to negotiate changes to the technical specification of the product, to agree delivery times and to negotiate the price. Direct contact is of value to the business manufacturer because it enables this adjustment/negotiation process to take place.

The typical pattern of direct export distribution in relation to business goods is set out in Figure 14.2.

Figure 14.2: Distribution channels for business goods



Intermediaries

Intermediaries between the manufacturer and the end user of the product provide a number of useful services for the manufacturer. They help the process of finding customers and of promoting the sales of the product. Many also help the manufacturer by putting capital into the system by buying the product.

The changing nature of distribution means that it is more useful to consider the activities performed by channel intermediaries, rather than simply their place in the distribution chain. The roles performed by distribution channel intermediaries can be defined by the range and extent of the activities that they perform – for example:

- The assortment of products that they stock.
- The number of customers that they have direct access to.
- The amount of marketing communications support that they provide.
- The extent to which they buy in bulk and then sell in smaller quantities.
- The amount of capital that they provide. In the case of cash-and-carry types of operation, the capital will be provided by other channel members. Goods might be supplied by manufacturers on 30 or 60 days payment terms. If the cash-and-carry, on average, sells the product for cash to retailers within five days, then the manufacturer and the retailer (who might hold stock on average for, say, 10 days) will each add working capital to the system.
- The amount of distribution logistics services that they perform, e.g. local delivery.

Thus, wholesalers and distributors are expected to buy in large quantities, to stock a wide range or assortment of products, to provide capital and local delivery, and to promote the sale of the product. Because of this range of activities, the wholesaler/distributor would typically expect a higher profit margin than an agent.

Note that an agent does not buy the product but acts on behalf of the manufacturer. The agent searches for customers and if the sale is made, it is referred back to the manufacturer.

One consequence of international business is that the number of levels of intermediaries is usually greater than in domestic markets. In some countries, for example Japan and Italy, there are a number of different national, regional and local wholesalers who handle the product before it reaches the retailer level. The extra levels make it difficult for the manufacturer to get close to the end customer.

This means that it is difficult to use sales promotions and it is difficult to learn very much about the retailer or the final consumer, because the contact and knowledge are contained within this multiplicity of wholesalers. In addition, each extra level in the distribution channel adds to the final price through the extra profit margins

The retailer is in a strong position regarding information. He or she is in contact with the customer and is in a position to build knowledge about customers and buying behaviour. Even if the retailer does not formally evaluate the customers, he or she is in close contact with the culture of the area in which he or she trades.

Retailers generally operate in much smaller quantities than wholesalers – in LDCs in particular, they might exist on very low levels of sale, with a small assortment of products and with very modest stock or inventory levels. However, retailers in some countries will perform quite different activities. These differences are most marked between major retailers in industrially advanced countries and retailers in rural parts of LDCs.

B. DISTRIBUTION CHANNEL RELATIONSHIPS

In an ideal world, manufacturers would expect that distribution intermediaries would provide 100% support for their products. In turn intermediaries would expect that manufacturers would provide them with products that customers were anxious to buy and, in selling these products, would make high profits. The real world is, of course, rather different. Manufacturers have to work hard to gain the support of intermediaries and intermediaries have to battle hard to be successful in the competitive hurly-burly of the market-place.

In order to illustrate the nature of distribution channel relationships and the ways in which these can be influenced by cultural factors, we will look at the Keiretsu in Japan and retailing in advanced and lesser developed economies.

Keiretsu

The Keiretsu is a distinctive type of business organisation found in Japan. The Keiretsu are linked together through a whole series of financial arrangements, interlocking directorships and social and historical links, based on Japanese values of personal service, that form a very powerful, cohesive relationship between the constituent parts of the Keiretsu. There are three types of Keiretsu – financial, production and sales distribution. The sales distribution Keiretsu are distribution channel arrangements that link manufacturers with wholesalers at varying levels and with retailers.

An important element of the Keiretsu is its the importance attached to high quality personal service. As viewed from some perspectives, this would make the channel inefficient because of its high costs. However, in the Japanese context it is efficient because customers are prepared to pay the extra price for the services that they value.

Throughout the country, high levels of service are an intrinsic part of Japanese culture. Similarly, an important expectation within the Japanese distribution system is that of high quality and personal service. Whilst it is also true that high levels of service are important in the US, the way in which service is expected is rather different. In Japan, service means:

- Easy availability through long opening hours
- Easy availability by physical closeness
- Good delivery services
- Good credit terms

- A ready acceptance of the return of goods even if there is no reason for the goods to be rejected, for example they were not damaged in transit.

In the US, the expectation of service is characterised by attention to low price efficiency. US distribution is based on large size, substantial mechanisation and computerisation. The people component of the US is much less important within the perception of what is good service.

To facilitate the level of service which links the Keiretsu, it is necessary to have large numbers of retailers and wholesalers and this is true in the distribution channel where many companies are very small, usually employing just a few people

It is extremely difficult for non-Japanese companies to gain entry into the Keiretsu distribution system. Non-Japanese companies cannot deliver a Japanese service because of obvious linguistic and cultural differences. It is this reason that is at the heart of the inability of non-Japanese companies to build successful levels of sales in Japan. In order to enter the Japanese distribution system, non-Japanese companies will need to find ways of obtaining a joint venture or an alliance with a Japanese partner, or to persuade a Japanese trading company to sell their products. These trading companies, called Sogo Shosha, provide a culturally adapted interface into the Keiretsu. If this is done, the Japanese values expected with the Keiretsu system will be capable of being delivered.

Retailing in Industrially Advanced Countries

Retailers in industrially advanced countries develop aggressive approaches to manufacturers. In many instances it is the very large retailers that control the distribution channel. They perform the functions of wholesalers by buying in bulk, by distributing to their retail branches and by adding capital to the system. They even take on some of the activities of manufacturers through the development of own-label products and by specifying the types of products that they will stock and the price lines that they will sell them at.

In industrially advanced countries, the expectation of the retailer and the wholesaler is undergoing change. As retailers become more powerful, they express that power in the form of:

- More own-label products.
- The development of strong retailer images.
- The use of strong dedicated marketing communications programmes.
- The insistence on manufacturers contributing to the costs of retailer promotions in which their products are featured.
- The use of central head office buying with the help of specialised computer packages, forcing the manufacturer to deal through head office.
- Very specific requirements about delivery times, quantities and frequency of delivery.
- Aggressive bargaining about price and their profit margin.
- Difficulty in granting the “listing” for new products (without the necessary listing, new products cannot be stocked).

Manufacturers are currently engaged in “battles” with retailers. From the manufacturers’ perspective they are fighting to protect:

- Their profit margin
- Their “rights” to develop new products and to be the innovators of products in the distribution channel

- Their "rights" to maintain strong brand images.

Retailing in Less Developed Countries

Retailers in less developed countries show a number of differences from retailers in more advanced countries:

- The level of concentration of retail power will be much less. This means that manufacturers are relatively more important in the distribution channel.
- Retailers are often local, are comparatively unsophisticated in their use of site selection techniques, and will make limited use of technology in retailing.
- The size of retail outlets and the range of product assortment will be small.
- Retail stores will be based on the name and personality of the owner, or on the types of product that are sold in the shop. In industrially advanced countries, retailing concepts such as Toys "R" Us or the Early Learning Centre are commercially successful.
- Retailers are mainly reactive to manufacturer marketing communications. The latter's promotions are welcomed because they help sell products for the retailer. In addition, they make the retail shop more interesting.

Manufacturers have more power in retailing systems in which there are such low concentration ratios. The retailer is too small and too fragmented to build power, and the manufacturer and wholesaler will have control in the distribution channel. On the other hand, the cost of distributing products to many small outlets can be very high.

In the future, these retailers (more particularly in the main urban centres) will become more like the retailers in more industrially advanced countries. Another influence will be felt through the moves of retailers to increase the international scope of their operations. As the internationalism expands, these retailers might enter LDCs. In this way, some of the more advanced retailing practices will be diffused into the less advanced retailing of the LDCs. As retailing changes in LDCs, manufacturers' expectations will need to change also.

C. PLANNING AND MANAGING INTERNATIONAL CHANNELS OF DISTRIBUTION

The key elements and considerations in planning and managing international channels of distribution are similar to those encountered in planning and managing channels of distribution in domestic markets. You should therefore already be familiar with the nature of these decisions, but it would be useful to remind ourselves of the key elements, and in particular any additional issues and complexities, which arise when planning these elements of distribution in international markets.

Key Decision Areas in Channels of Distribution

The following represent the key decision areas in planning and managing channels of distribution together with any special considerations with regard to these key decision areas when planning international channels of distribution.

(a) Channel length

The first decision for the channel planner is to determine the number of levels between the producer/business and the final customer in the channel of distribution (the channel length). The shortest channels are those where the business sells direct to the final customer with no

intermediaries being involved. This is sometimes referred to as a "zero level channel" and essentially involves the business in direct marketing. Zero level channels are often used in business-to-business markets, particularly where products are expensive or highly technical in nature, as well as in direct marketing in consumer product markets.

This type of channel arrangement affords the business a much greater degree of control over how the product or service is marketed and obviously has the advantage of enabling direct contact with a company's customers, with all the attendant advantages that this gives rise to.

Perhaps the biggest disadvantage of the zero level channel in international markets is that it requires the business to have the necessary expertise to be able to deal with foreign customers often across a wide range of different geographical areas of the world. Remember that businesses use intermediaries for a variety of reasons, but essentially they are used where they can perform marketing activities and functions more effectively than the businesses themselves. Because of the often wide disparity between different markets and customers when considering international, as opposed to purely domestic, markets, very often the business has little choice other than to use intermediaries in the channel. In addition, zero level channels with no intermediaries often involve the business in exposure to much higher levels of investment and risk. As a result, much international business is characterised by the use of a variety of intermediaries by the business.

One stage up from the zero level channel is the one-level channel, where the business uses one type of intermediary to reach consumers. As the business adds different types of intermediaries to the channel, so the channel length increases. So, for example, if a business sells through a wholesaler and then through an international selling agent, two levels are introduced into the channel and the channel subsequently becomes longer.

Remember that, generally speaking, the longer the channel, the further the business is from the final customer and therefore the less control they will have. In addition, longer channels of distribution will tend to lead to the phenomenon of "price escalation" in international markets as each intermediary obviously requires a share of the profit. Again, the reasons why the business might use different intermediaries in the channel, therefore, are that the use of such intermediaries gives rise to superior effectiveness in performing the required channel functions and flows.

If anything, in recent years there has been a trend towards shorter channels with a growth of more direct marketing and the increased control and customer contact which this gives rise to.

(b) Types of intermediaries

The second decision area in channel design relates to the nature and types of intermediaries to be used in the channel. Obviously, to a great extent, this aspect of channel design is related to the decision about channel levels. The usual types of intermediaries used in domestic channel arrangements such as wholesalers, retailers, agents and brokers, are all available to the international marketing channel planner.

However, over and above these normal domestic channel intermediaries, the international business has in fact an almost bewildering array of types of intermediaries when it comes to the international channel arrangement. So, for example, the business can choose between domestic purchasing agents, export houses, trading companies, licensees, overseas agents, export consortia, international trading companies, overseas buying offices, confirming houses and so on. Quite simply, then, identifying and selecting the most effective types of intermediaries can be much more difficult and complex compared to the selection process for domestic channels.

Once again, though, the business is looking for the most cost-effective combination of types of intermediaries to achieve their given marketing objectives.

(c) Channel/market coverage (number of intermediaries)

Sometimes also referred to as distribution density, this decision regarding channel design relates to the number of intermediaries to be used at each level which in turn, of course, affects the nature and extent of market coverage.

In some markets, customers require products to be available in a wide range of locations and types of intermediaries. Many consumer goods fall into this category. In this situation, large numbers of intermediaries are required, giving wide-ranging market coverage and hence a distribution density which is **intensive**. At the other extreme, the market may be one where only a small number of customers are required to be reached and therefore perhaps only one or two specially selected intermediaries will be used, giving **exclusive** distribution. In between these two extremes is **selective** distribution, where a relatively small number of intermediaries are used at each level, but more than the one or two found in exclusive distribution.

(d) Tasks, responsibilities and terms

This element of channel design and decision-making relates to what is required to be performed in the channel of distribution with regard to tasks and responsibilities and who is to perform these. So, for example, someone in the channel of distribution may have to take responsibility for credit or after-sales service. The channel design decision must consider these tasks and responsibilities in advance and determine the most cost-effective way of performing them. Moreover, it is important to ensure that these tasks are allocated and agreed between channel members as part of the channel's design decision.

(e) Distribution logistics and service levels

Overall, distribution channels should be designed to get the right products, to the right customers, in the right place at the right time and in the right condition. In achieving this, distribution is about the planning, implementation and control of physical flows of materials, services, and information from the business to customers. In recent years, these flows and their management have been referred to as physical distribution logistics. The business must therefore design channels based on the flows required to get products from the business's organisation to final customers. Moreover, physical flows in channels of distribution need to be managed so as to deliver predetermined levels of service to customers.

We shall be looking at elements of service levels from the design of the logistical system later in the unit, but examples of service levels affected by the design of the logistics system are:

- Delivery response times
- Consistency and reliability of delivery
- Flexibility of delivery and ordering systems
- After-sales support

The increased recognition of the importance of this element has led to the growth of a whole new area of the management of distribution, usually referred to as logistics or logistical planning. The importance of planning the logistics element of channels is heightened in international markets for a number of reasons.

- Distributing across national boundaries to often geographically disparate areas of the world can substantially increase distribution costs, and hence the potential pay-off from designing systems which minimise these costs.
- Developments in production and manufacturing systems such as just-in-time and zero defects or Kanban systems (which are systems of manufacturing based on purchasing in small but frequent batches) place an increasing premium on effective distribution and delivery systems to customers.
- Customers are much more demanding with regard to what they expect from the business with regard to distribution. Not only do customers expect their products and services to be delivered more quickly, but also with additional levels of service and in perfect condition.

These then are some of the key decision areas in selecting channels of distribution, but what are some of the considerations in making these decisions – how can the business choose between alternative channel arrangements? We shall now turn our attention to the key influences on this choice.

Selection of Channels

As so often with marketing mix decisions, a very wide range of factors have the potential to affect the design and selection of appropriate channels. A number of writers on distribution have used the notion of identifying certain "C" factors to help explore and explain the key factors affecting the design and selection of distribution channels. The main "C"s are:

(a) Cost

Two kinds of cost need to be considered. The first cost is that involved in setting up the channel in the first place. The second kind of cost is that of maintaining the distribution channel. The main costs in this area are the total profit margins paid to distribution intermediaries that make up the difference (excluding tariff and other government-imposed duties) between ex-factory cost and the final price paid by the end user. The other cost element is the company selling costs associated with the distribution channel.

(b) Capital requirement

This C carries on from above. It reminds us of the different capital requirements of different channel arrangements. All arrangements will require capital; however, when the company establishes its own internal channels (for example its own distribution depot or its own direct salesforce in a country), its need for capital will be greatest.

(c) Control

It is difficult to exert direct control in international marketing. It is often too expensive to establish the company's own salesforce. It is therefore usual, particularly in export marketing, to use distribution channel intermediaries. Because of this, it is important to select intermediaries over whom the company can exert some measure of control.

(d) Coverage

Most companies seek to cover all, or at least the most important parts, of each country market. The performance of the distribution channel will be assessed by the amount of the market that is covered. Market coverage can be measured in:

- ***Geographic coverage*** of the country – In some countries this might not be essential, because the majority of the market might be contained within a small part of the country.

For example, over half of the population of Japan lives in the Tokyo-Nagoya-Osaka market area.

- ***Market coverage*** – For most companies, market coverage will be more important than geographic coverage.

(e) Character

The distribution channel selected must fit the existing and the evolving requirements of the product and the company. Food products have perishability as an important characteristic. Business products are characterised by a customer need for high levels of after-sales service. If the distribution channel does not fit the character requirements, it will not have the required level of performance.

(f) Continuity

Distribution channels need to continue to perform over long periods of time. It is difficult to change from one type of distribution channel to another. However, within one type of channel it is quite possible to lose channel members and with them continuity between channel members. If agents are used in a country, it is quite possible for the agent to retire or to decide to move to a different type of business. It might be difficult to replace the agent if no similar agent exists to cover the same geographic or market area.

(g) Company

This C encompasses a number of factors. To begin with, company objectives influence the choice of channels of distribution. Where a company is wishing to grow, for example, it may wish to secure intensive channel coverage. Another company factor is company resources. Where a company lacks sufficient resources, it may have to use more levels of intermediaries. Finally, a company's organisational structure, and in particular its selected methods of market entry will have a direct effect on the channels of distribution used.

(h) Competition

Competition, of course, affects every facet of a company's marketing strategy and mix, and channels are no different in this respect. A company will therefore need to consider the sort of channel arrangements used by competitors in a given country. A company may choose to use similar channel arrangements to key competitors or perhaps may instead seek to develop different, and possibly innovative, channels compared to their competitors.

(i) Culture

Culture, too, affects every facet of a company's marketing strategy and mix as we have already seen. With regard to channels of distribution, certain products in a country may only be available through certain distribution outlets due to cultural practices. So, for example, in some countries certain foodstuffs are only available through specialised retailers. Culture may also affect specific distribution practices, such as opening hours for retail outlets, etc.

(j) Customers

Finally, though in some ways most importantly, customers also affect channel decisions. Obviously channel arrangements must fit with target market customers and their needs and wants.

Working with Individual Intermediaries

Working effectively with intermediaries means that the processes of selecting, managing, motivating and controlling them must be effective.

(a) Selection

Selecting individual intermediaries in the channel is crucially important. Obviously the choice of intermediaries depends on many factors including the overall channel configuration. The fortunate business has a number of intermediaries to choose between, all of which are able and willing to take on and complete the necessary distribution tasks. All too often, however, the business is faced with little choice and must take what is available.

Where the business is able to select between alternative individual intermediaries, the following are likely to be key factors in choice:

- Skills, expertise and experience of the intermediary.
- Enthusiasm and commitment of the intermediary.
- Fit with/coverage of target market.
- Financial stability.
- Sales potential.
- Reputation.

Often the selection criteria are weighted heavily in favour of sales volume potential. The performance of specific intermediaries can be measured against the target levels of sales that the intermediary will be expected to provide. This precise form of performance measurement is most useful when the company is using a small number of agents or distributors. It is not practical if the company is using retailers, because the company will have less information about the sales levels of individual retailers.

The most important element that companies are concerned about in the long term will be the **profit contribution** that the distribution channel and individual intermediaries can make to the company. Companies that focus on short-term profit return will place great emphasis on profit contribution, even in the first year of the operation of a particular distribution channel arrangement. Companies with a long-term view of profit importance will view the performance criteria of sales growth, market coverage and market share as much more important in the long term. They will view the short-term success as the foundation for long-term profitability.

(b) Management and motivation

Obviously companies, having selected individual channel members, need to manage and motivate them. The tasks, responsibilities and roles of individual channel members determined earlier as part of the overall channel configuration decision should be communicated and agreed with those individuals. It is vital that channel members know exactly what is involved in terms of their agreement with a company. Specific arrangements, such as responsibilities for joint promotions, pricing and discounts, need to be formalised.

Companies should use the range of management and motivational methods that they would use with their own domestic salesforce. Motivation can be influenced by good quality marketing communications and Western companies have considerable experience in providing various types of sales incentive schemes and psychological rewards. The effectiveness of different methods will vary. The important influence of cultural difference should be considered. In

some situations, personal and group esteem and honour will be more important than individual competitive pressure to hit sales targets.

(c) Control

Finally, the business must ensure that there are adequate systems for evaluating and controlling intermediaries. Very often, when dealing with intermediaries in international markets, control is more difficult to achieve because the business is working at a distance. Obviously, control and measures of performance will need to be agreed in advance, together with actions that can be taken in the event of either party being dissatisfied. Wherever possible, the business and individual intermediaries should draw up contractual agreements with regard to, for example, standards of performance, terms, conditions and roles, methods and bases of payment, and conditions for the ending of a contract by either party.

It is important to note that it can sometimes be very difficult, and therefore very costly, to withdraw from contractual arrangements with intermediaries in international markets. Needless to say this heightens the importance of getting it right in the first place.

D. TRENDS IN INTERNATIONAL DISTRIBUTION

Like all areas of marketing, distribution channels and arrangements are constantly evolving and changing. If anything, however, international distribution is one of the most dynamic areas of contemporary marketing. Distribution patterns, channel arrangements, techniques and systems of management have all undergone major changes over the last ten years and will continue to do so. The international business needs to be at the cutting edge of these changes and their implications for the design and management of effective international and global channels of distribution. It is fair to say that distribution and logistics are increasingly becoming the new battleground in international marketing as companies seek to gain the competitive edge. Amongst the most important developments that are taking place with regard to international channels of distribution, are the following:

(a) The rise of the global retailer

Increasingly, retailing is becoming global in nature. For example, the American supermarket retailer, Walmart, has recently acquired the British supermarket retailer, Asda, in order to expand its operations in Europe. IKEA, Benetton and Aldi, are all examples of companies with international and global perspectives and operations.

(b) The increased power and size of retailers

In virtually all parts of the world, smaller retailers are losing out to the large organisations. Not only is this true of individual outlets, such as the growth of the hypermarket, but it is also true of the retail organisations themselves, who have increasingly become large-scale multiples across a wide range of different product markets.

(c) The growth of vertical marketing channels

“Vertical” marketing channels are channels where the different levels in the channel are co-ordinated to act almost as a single organisation. In part the growth of vertical marketing channels is due to the increased size of certain channel members, and in particular the retailers already mentioned. The large retailers can, because of their huge buying and market power, effectively control other members of the channel in order to achieve co-ordinated marketing.

(d) The growth of direct marketing

We have already mentioned the trend towards more direct channel arrangements. This has been facilitated by improved technology and marketing infrastructures, such as improved databases available to businesses. The growth of direct marketing and channels also reflects changing lifestyles, with customers having less time and inclination to leave their homes in order to do their shopping.

(e) Information technology and the Internet

Related to the growth of direct marketing, once again the ubiquitous Internet is changing channels of distribution. Mobile phones, the expanded ownership of PCs and the growth in teleshopping will obviously serve to fuel this growth further. At the moment, in most parts of the world, Internet shopping is restricted to just a few product categories but some of the most successful uses to date of the Internet as a channel of distribution have been the purchasing of books and holidays and certain specialised areas such as auctions. There is no doubt, however, that once again this will be one of the fastest growing types of distribution in the future.

(f) The growth in importance of physical distribution and logistics

We have already touched on the importance of physical distribution and logistics in planning distribution and will be going on to explore it detail in the next section. At this stage it is sufficient to note, however, that the high costs of physical distribution, together with the potential savings for businesses in this area, have served to focus business's attention increasingly on this aspect of distribution.

Another major reason, however, for the growth of effective physical distribution and logistics has been the recognition by customers of the importance for companies to manage the whole of the supply value chain. Companies have realised that a key factor in competitive success is the effective management of these supply chain activities.

E. DISTRIBUTION LOGISTICS

Distribution logistics is the term used to cover all those activities in moving and facilitating the movement of products from the production point to the customer. In international marketing this will usually involve longer journeys, more types (or modes) of transport and considerable amounts of documentation.

It is an area which in the past has had a low profile in the marketing department's list of priorities. Businesses often think that completion of marketing plans and a product ready for despatch means their job is complete. It is, however, becoming increasingly recognised that distribution is an integral part of the product offering and a tool that can be used to win competitive advantage.

Logistics is an area in which the tight fit of detail is essential. Documents need to be 100% correct and time schedules need to be met accurately. In addition to this requirement at an implementational level, it is important to note the strategy decisions about what is the best balance between service levels to customers and the costs incurred by the company.

Logistics as a Strategic Issue

We have looked in detail in earlier study units at the complexities of marketing in an international arena, the need for informed strategic planning and an organisation that is capable of being customer-focused, often in subtly different ways. It is, therefore, very short-sighted for a company to assume that once the product has left the factory, so to speak, their job is at an end. It is, of course, only when

the customer is in possession of a product that is meeting the need/want for which it was purchased that customer satisfaction can be achieved.

The importance of this element of the process is changing for a number of reasons:

- The costs associated with distribution can frequently account for up to 50% of the product cost – possibly more for exported products.
- Availability and delivery are being utilised by the "manufacturer" to win competitive advantage.
- Across the world, customers are demanding more convenience and using distribution to evaluate potential suppliers – for example, in telebanking and TV shopping.
- The growth of just-in-time systems and material management.
- There have been changes in the balance of power between distributors and manufacturers, which has resulted in the squeezing of margins and refusal of access to customers, for example Kellogs and UK supermarkets.
- As we have mentioned previously, there has been an increased recognition of the importance of managing all the elements of the value chain, and in this case, all the supply aspects of this chain.
- Once again, developments in information technology are also facilitating a more strategic approach to the management of this part of the business. Perhaps the best example of a development in this area is the growth of Electronic Data Interchange (EDI) systems. EDI systems essentially link suppliers and customers in the value chain through on-line computer systems.

  This means that customers and suppliers are directly linked and immediate responses can be made where customers require further supplies. The customer's own stock system will sense when an order needs to be placed and this will be relayed automatically to a pre-determined supplier through a computer link. The order will be raised automatically and dealt with at the other end in the same way by the supplier's computer. Instructions will be sent to the supplier's warehouse and delivery systems to forward the order without delay and all the accompanying paperwork, such as invoices, etc. will be raised and dealt with at the same time. Obviously, systems like these require close co-operation between the different members of the value chain and above all require effective logistics systems to be in place.

We have considered throughout this course the requirements of successful international trade and distribution is clearly an integral aspect of the strategic planning process. The management process and opportunities for control may be limited because of political, financial, geographical or cultural considerations, but the planning of distribution must be undertaken only on the basis of a detailed understanding of the market and its characteristics.

The start of distribution logistics planning must be with the customer. As we shall see below, there is a need to identify both the level and elements of service that customers require – what they value and, most importantly, what they will pay for. It is also necessary to be aware of what the competition is offering and at what price. Companies will then be in a position to translate requirements into costs (for the company) and benefits (to the customer).

It has now become increasingly evident that distribution logistics strategy can strongly influence the quality of customer care, the potential for increases in profitability and even change a product's positioning.

Key Elements and Decision Areas of the Logistics System

At one time, most organisations would have considered that physical distribution was concerned primarily with order processing and delivery systems. The growth of the notion of logistics has led to a much wider, and more realistic, view of the key elements of the physical distribution and logistics system. It is now recognised that there are many interrelated facets to the logistics system and that each of these facets must be managed in an integrated way. The following are now recognised as being the key elements of a logistics system:

- Inventory management
- Order processing and documentation
- Facilities and storage, e.g. warehousing
- Transport management
- Materials handling
- Packaging

These elements of the logistics system are no different for the international business. Needless to say, however, distance and geographical and cultural dispersion make the management of this area and these elements potentially much more complex for the international business. So, for example, in considering inventory management, the international business must consider the potential delays in the system with regard to delivery of stocks due to greater distances. Similarly, the modes of transport for the international business will involve consideration of those modes which are used to transport products over long distances and often across large bodies of land or water. Put simply, the international business is likely to use a much wider range of transport types than the purely domestic business.

Materials handling and packaging must also reflect the fact that products destined for international markets are likely to be handled much more frequently during the distribution process and are therefore more likely to be damaged. Similarly, packaging and delivery systems may need to reflect, for example, differences in climate and environmental conditions between different markets. The costs of distribution are likely to be much higher for the international business, underlining the importance of this aspect of the marketing process.

Finally, we know that the output of the physical distribution and logistics system, such as delivery times, is a major factor in supplier choice in international markets. If a company or a country develops a reputation for poor and unreliable delivery, it will quickly begin to lose market share in international markets.

Associated with these key elements of the logistics system, the business must decide on the following aspects:

- Stock levels
- Order cycle times and ordering systems
- Methods of transport
- Warehousing and storage, handling and packaging systems.

You should remember that all of these decisions must be made in conjunction with the actual channel decisions such as mode of entry, types of distributors, distributor coverage, etc. We can see that designing the physical distribution/logistics systems is a complex and difficult process. What then are the major factors influencing these decisions, and what should serve to shape the design of the logistics system?

Planning the Logistics System – Service Levels and Costs

The most important thing to remember about the logistics system is that it has a major influence on levels of customer service. In designing the physical distribution/logistics system, therefore, the start point should be what we want the output of the system to provide. Specifically, we need to determine the required service levels from the system – for example, it is likely that delivery time reliability, goods arriving with zero defects and a high level of responsiveness to customer requirements will be significant customer requirements.

The following represent the key elements of customer service which stem from the design of an operation of the logistics system:

- Delivery response time
- Minimum/maximum order size
- Flexibility, e.g. ability to handle special or rush orders
- Consistency and reliability of delivery
- Order status information
- Ease of ordering, including paperwork and documentation
- Condition of delivered goods
- After-sales support

We can immediately see from this list of service elements why distribution and logistics is so important to customers and therefore to a company's competitive success. In looking at these elements of customer service, one might be tempted to think that ideally the logistics system should be designed so as to give the maximum level of service to every customer. So, for example, one should aim to have the shortest possible delivery times, the simplest procedures for handling orders, maximum flexibility and so on. At the very least, it might be argued, a company should be better in all of these areas than its competitors if it is to succeed.

However, although customers are increasingly demanding higher and higher levels of service from their suppliers, we have to remember that the other half of the decision about the design of the logistics system is concerned with costs. Quite simply, higher service levels in any of these areas increases costs for a company. Put another way, by offering near perfect service levels a company may be generating sales and business, but not making any profits. Alternatively if the company tries to recoup these costs of improved service levels it may find its prices are simply too high. The business therefore has to balance increased costs with improved service levels.

We should therefore design the system with regard to service levels around an identification of customers' requirements and in particular what constitutes value in terms of service levels to the customers. So, for example, we need to assess if the customer would value smaller minimum orders or the ability to deal with special orders, and whether the customer is prepared to pay for these additional levels of service. The physical distribution and logistics system should be designed so as to provide pre-specified levels of customer service at minimum cost. When this has been decided, the logistics system can then be designed as a system considering total costs.

F. THE TOTAL COST CONCEPT

The total cost concept of distribution is concerned with identifying all the costs involved in distribution as a total system cost. This is particularly important because of the higher cost levels in

international marketing. Of particular significance is the inclusion in the system of the costs associated with lost sales caused by failures in service levels, such as making the customer wait for delivery.

It is quite easy to reduce costs of individual parts of the distribution logistics system. Transport costs can be cut by using slower and less frequent deliveries. Inventory costs can be reduced by holding lower levels of stock. Less stockholding can reduce warehouse operating costs. However, the consequence of smaller stocks can be to increase the likelihood that products will be out of stock. If products are out of stock, customers will have to wait for new stock to arrive. Some customers will not wait. They will cancel their order and buy from the competition. It should be remembered, therefore, that the "big picture" and the overall impact of these decisions must always be taken into consideration before taking action for short-term gain.

Thus, the total cost concept involves:

- Identifying all the costs incurred.
- Taking account of the influence of changes in one activity on the rest of the system – this causes trade-offs between one activity and another.
- Taking account of the ways in which the customer is affected by changes in distribution.

The main costs in distribution logistics are transport, warehouse, inventory, order processing and documentation, packing and packaging and the costs of lost sales.

Remember that in international marketing most of these elements will cost more than in domestic marketing. For example, product packaging will need to change to take account of the requirements of different distribution channels and cultural conditions – the extra bumping, jolting and need to cope with climatic change mean that international packing has to be more substantial and will, therefore, be more expensive.

G. MODES OF TRANSPORT

We can illustrate many of the concepts and concerns in distribution logistics by considering the decision about modes of transport. Transport, through its five modes, provides many options, each of which has specific requirements and implications.

The five main modes of transport are road, water, pipeline, rail and air. In international distribution logistics, goods might use several modes before they reach their final destination. The use of containers makes the switching costs from one mode to another much lower than they used to be in the days of loose cargo and high labour involvement. The differences between the sophisticated capital-intensive distribution logistics in industrially advanced countries and the "low-tech" labour-intensive methods used in some LDCs can impose considerable strains on the development of efficient logistics.

Again, the SLEPT factors – and particularly, culture – will considerably influence the whole process and its efficiency.

The final choice of which mode of transport to use will be influenced strongly by price. Other factors in the decision are:

- The requirements of the product – for example, strawberries will perish and the best market prices will be lost if the delivery is not quick and reliable.

- The time taken for the particular mode and the overall transport time taking account of all the interconnections and waiting times.
- The specification of the customer, who may wish to specify the use of the national carrier of his or her country – for example, the state airline or ships sailing under the national flag.

Both the availability and the costs of different modes of transport can vary considerably from one country to another, particularly when considering industrially advanced countries compared to lesser developed countries. Clearly, cost is a key consideration in the choice of transport modes, but once again total costs should be used to examine trade-offs between various parts of the system.

The interconnections between transport costs and the other parts of the distribution logistics system need to be considered. It would be wrong to identify air freight as high-cost and therefore only suitable for a narrow range of products. If the trade-offs between various parts of the system are considered, we will find that the high cost per mile or per kilometre travelled by air can be offset (sometimes only partially) by:

- Lower inventory requirements because of the faster delivery
- Less packing requirements because of the comparative smoothness of air travel
- Less insurance cost because of shorter transit times and lower damage risk
- A lower cost of lost sales – the greater responsiveness of air freight to customer requirements will encourage customer demand to increase.

Thus, we can see that water transport is comparatively slow, but it has a low cost per tonne/kilometre which makes it particularly appealing for long journey requirements for bulky goods. The low cost of the journey can be traded off against:

- The long transit time
- The need for extra inventory to cover the long transit time
- Extra packing to withstand ocean travel
- Extra insurance to cover the damage risk and the longer transit time
- The need for interconnections with other transport modes, increasing administration and documentation
- The influence on lost sales – this can be minimised if water transport achieves regular and reliable delivery schedules.

Study Unit 15

The Extended Marketing Mix

Contents ***Page***

INTRODUCTION

The notion of the four Ps of the marketing mix has dominated marketing thought, research and practice since the early 1950s. Usually credited to the American, Neil Borden, the conventional four Ps marketing mix framework suggests that the main ingredients of marketing are product, price, place (distribution and logistics) and promotion. Because of this, the marketer must understand the nature and scope of each of these four key mix ingredients, and in particular understand how to plan each and combine them into effective marketing programs. In the context of international marketing, of course, the business must also understand the added complexities and issues involved in managing these four elements of the mix when marketing across international boundaries.

There is no doubt that the conventional four Ps elements are still key ingredients in marketing plans and strategies. However, it is now suggested that for a number of reasons, the original four Ps framework of the marketing mix needs to be extended to incorporate additional mix elements. There are several reasons for this extended marketing mix, the most important of which we shall explain in this study unit. It is now generally agreed that a more appropriate view of the marketing mix elements in today's marketing environment is one which includes the additional marketing mix elements of people, process and physical evidence, giving seven Ps now as opposed to the original four.

In addition to this extension of the marketing mix elements, a concurrent and equally significant development in marketing thought, research and practice has been the growth of "relationship marketing" which, as we will see, has fundamentally altered the application and use of the marketing mix elements involving, as it does, a very different concept of marketing practices.

In this study unit we shall be looking at the reasons for the extended marketing mix and each of the three new mix elements. We shall also be looking at the meaning and implications of the relationship marketing approach. We start, though, by considering the particular characteristics of marketing service provision which has been responsible, to a large extent, for the interest shown in the extended marketing mix..

A. SERVICE PRODUCT CHARACTERISTICS

Earlier in the course we discussed the product element of the marketing mix. Increasingly, businesses are making a distinction between two major types of products in markets – namely the distinction between physical products and service products.

Physical products include cars, computers, clothing, components, raw materials and so on and, as the term implies, all those products which are essentially tangible. Service products, however, are essentially intangible and include products such as financial services, insurance, consultancy, holidays, entertainment and leisure, and so on. In part, the need to distinguish between these two types of products and markets has been prompted by the fact that in many parts of the world, and especially in developed economies, service industries have been amongst the fastest growing sectors whereas physical product markets, and especially those involving manufactured products, have been in decline. In fact, many developed economies, such as the United Kingdom, France, Germany and the United States, are now classified as service economies.

In the context of international business, the growth of the global company, which initially began with the manufacturing companies, has now spread to the service sectors to the extent that some of the largest multinational companies are service product organisations such as McDonalds, Hertz, American Express, Federal Express, Holiday Inns and so on.

Service products have a number of special characteristics compared to their physical product counterparts and, consequently, require a somewhat different approach to marketing. In particular, the these characteristics give rise to the need to consider the additional marketing mix elements. There are four such key characteristics, as discussed below.

(a) Intangibility

This is probably the easiest of the special distinguishing characteristics of service products to understand. With physical products we can touch, see, and often smell the product. This means that we can pick the product off the supermarket shelf and examine and assess its weight, handle, finish and so on. With a service product, however, the product is essentially intangible and therefore the customer cannot handle, touch and assess the product in the same way. This may seem rather obvious, but it has important marketing implications.

- Consumers often find the evaluation of new service products and concepts very difficult, which in turn may place an increased emphasis on aspects such as word of mouth recommendation, company and brand reputation, the help and advice of the salesperson, etc.
- Intangibility makes it difficult for the business to find ways of making the product stand out from competitor products. Service products can, therefore, be difficult to differentiate.
- It can be more difficult to patent and protect new service products compared to physical products.

As we shall see when we consider the extended marketing mix for service products, the service provider may seek to make the product appear more tangible by drawing attention to any tangible attributes of the product or company which surround the purchase and consumption of the service product. This may include aspects such as the premises in which the product is produced and marketed, the appearance of the staff delivering the service and so on.

(b) Perishability

Compared to intangibility, the notion of service products being characterised as highly perishable, and indeed more perishable than their physical product counterparts, seems strange. After all, what could be more perishable than, say, fresh fruit and how can a service product decay?

In fact, many service products are amongst the most perishable in the market place. Essentially this high degree of perishability derives from the fact that, unlike physical products, service products cannot be stored. If they are unsold, therefore, they cannot be put into stock and brought out and sold again at a later date. A good example of this is the service product of an airline seat. If a seat is unfilled on an aircraft at the time of take off, then the revenue generating capacity of this seat is lost for ever. Admittedly, this is a different view of the notion of “perishability” compared to, say, food products, or even fashion products, but it is nonetheless the same effect in so far as the business is concerned.

The highly perishable nature of service products places an increased onus on the business to synchronise, and as far as possible, match demand with supply. This, in turn, has implications for many facets of planning – for example, substantial use is made in service product marketing of aspects such as “off peak pricing”, special promotional offers and so on.

As we shall see, the element of the extended marketing mix for service products most affected by the perishability characteristic is that of “process”.

(c) Heterogeneity

Unlike many physical products which can be manufactured to predetermined and uniform standards, service products are often much more difficult to standardise. Essentially, this is because service products involve a much higher degree of "people content". Service exchanges are characterised by a high degree of interaction between both service provider and service receiver and as we all know, people are much less predictable and more variable than production and manufacturing processes.

Even where the service product has been standardised as much as possible – through, for example, standardised service elements, staff training and so on – individual customers may still experience the service offer in different ways. The result of all this is that it is much more difficult to "control" the marketing transaction and customer experiences, and from the customer's perspective, the experience of the service product encounter may be much less predictable.

Again, as we shall see when we consider the extended elements of the mix, businesses can attempt to remove some of this uncertainty and increase the standardisation of the service product through the design and management of each of the extended marketing mix elements for services.

(d) Inseparability

For many service products, consumption and production occur simultaneously, often on the supplier's own premises. So, for example, when we visit a hairdresser, the service product is produced and consumed there and then on the service provider's premises.

There are several implications of this inseparability of service products for the marketer. For example, it can severely restrict the potential size of the market which the service provider is able to cope with, and hence may severely limit, say, economies of scale. Perhaps the most obvious implication of this characteristic of services, however, is the increased emphasis it places on the people element of the service provider's marketing mix and the physical/tangible attributes of where the service is produced and consumed. In addition, it means that the business must pay careful attention to managing any direct interactions between the company and its consumers, and so again, has implications for aspects such as staff training and appearances.

These, then, are some of the special characteristics of services which in turn have important implications for a variety of marketing activities. Remember, though, it is these characteristics which together have given rise to the extended marketing mix for services.

It is these characteristics which have implications for the marketing of service products. Clearly, the precise implications of each of these characteristics differ from product to product, but using the example hotel accommodation we can explore the way they affect the marketing of a service product.

Although there are many tangible attributes to a hotel and its accommodation, the core product is essentially intangible in that the customer is buying a pleasurable experience. This essentially intangible nature of the product can make it difficult for the customer to assess whether any particular hotel is likely to be satisfactory. Marketing hotel accommodation, therefore, must attempt to resolve this dilemma for the customer. Things like brochures and photographs are likely to be very important together with perhaps testimonials from satisfied customers. It would also help in marketing this intangible product to, for example, allow prospective customers to view the accommodation and the facilities before making a decision.

The perishability of the product is high. This means that the hotel management must carefully try to synchronise demand and supply so that hotel rooms are not left empty. This may involve, for example, off-peak pricing, special weekend packages, discounts for regular bookings from company representatives, etc.

Heterogeneity and inseparability mean that substantial attention should be paid to aspects such as staff training, staff appearance, and processes such as booking and reservation systems, etc.

B. THE EXTENDED MARKETING MIX

The growth of services marketing, together with the special characteristics of service products, which we have already outlined, have in turn led to the acceptance that the conventional four Ps of the marketing mix now need to be extended to include a further three Ps. Each of these three additional Ps therefore, is outlined and discussed below. Needless to say we shall consider each of these extra marketing mix elements in the context of international marketing.

People

This is the first additional marketing mix element in the extended marketing mix. Remember, with service products, the supplier and customer often meet face to face. Furthermore, in fact, with many service products, the product ***is*** the person(s) providing the service. So, for example, we often choose a particular service provider because of the skills, personality and so on of the person(s) providing the service. Even when the person is not central to the actual service product, the people element of the service provider can still be important in affecting a customer's experience of the service and any subsequent satisfaction or dissatisfaction.

Take the situation, say, of a meal at a restaurant. The actual meal may be excellent and the décor and the atmosphere of the restaurant exciting. The consumer's experience of a meal in this restaurant, however, may be ruined if the service is poor or the staff rude. It is vital that the people involved in providing the service, and especially those in direct contact with actual customers, are carefully selected, trained, motivated and presented. In short, the people element of the marketing mix is an essential ingredient in determining the degree of marketing effectiveness and success.

For the international marketer, managing the people element of the marketing mix may be more problematic than for purely domestic marketing. For a start, what works in one culture with regard to the people element of the mix may not be appropriate in another. For example, Americans demand a high degree of service and to some extent servility when purchasing and consuming. In a food establishment, therefore, the American customer often prefers waiters to be constantly at hand and to attend immediately to every requirement. This contrasts with the United Kingdom where many customers do not like this degree of attention when they are ordering or eating their meals. Similarly, staff in different cultures may object to, resist, or simply find it difficult to adapt to a "foreign" approach regarding how they operate and deal with customers.

The people element of the mix is the factor that gives rise to variability and lack of control in the service product offering and is therefore probably the most difficult to manage in the context of international marketing. There is no simple answer to the extent to which it is best to try and standardise the people element across different international markets through, for example, staff training, agreed procedures, etc. The international business must carefully assess the advantages and disadvantages of attempting a standardised approach depending on customer, competitor and company considerations.

Having said this, as we have seen for the other more conventional elements of the marketing mix, the move is towards greater uniformity and standardisation. Some companies, therefore, place considerable emphasis and effort on selection, training and motivation of staff so as to ensure greater uniformity in this element of the marketing mix.

Process

Process refers to how the service product is provided and delivered. For example, walk into McDonalds and they have a predetermined ordering and queuing system, standardised methods and procedures for cooking and delivering the food to tables and predetermined systems for seating, clearing and tidying tables. Process systems, therefore, can include aspects such as ordering systems, quality systems, queuing and delivery systems, customer support systems and so on.

Like people, the process elements of the marketing mix can substantially affect levels of customer satisfaction. These systems, therefore, should be carefully thought through and planned in advance as part of the total marketing effort. In the context of international marketing, standardising processes serves to increase the consistency of service and can therefore enhance the customer's experience. In fact, McDonalds is an excellent example of a company which has standardised its process systems throughout the world.

Once again, however, we need to be careful about such standardisation and in particular ensure that process procedures do not conflict with the cultural habits in a particular country. So, for example, in the United Kingdom, orderly queuing is the norm and therefore quite acceptable, whereas in other countries such queuing is alien to their cultural practices.

Physical Evidence

This third and final element of the extended marketing mix for services relates to those elements of the company's service offering which are more tangible even though they may be ancillary to the service itself. There is a range of types of such physical evidence, including such examples as the design and décor of the service premises, the writing paper, pens, entertainment information, and so on in a hotel bedroom and the appearance of service personnel, including uniforms, etc.

Many companies now spend considerable time, money and effort on the physical evidence of their marketing. This is important because, in effect, physical evidence can be used to make more tangible an otherwise intangible service, therefore helping to convey images and perceptions of, say, quality, to a customer. Physical evidence also helps in customer brand recognition and as such helps the company to differentiate itself from competitors.

Once again, international service companies are increasingly standardising elements of their physical evidence – so, for example, the décor of an international hotel group may be similar throughout the world. In the same way, the appearance of staff may be standardised through the use of company uniforms. As with people and process elements however, care should be taken to ensure that any physical evidence elements do not conflict with local customs and tastes.

Standardisation and the Extended Marketing Mix

Standardising any of the elements of the marketing mix usually gives rise to two potential major advantages. The first advantage to be gained from standardisation of the international marketing mix elements is the opportunity for cost reduction and economies of scale. The second major advantage is increased consistency and control over the marketing effort.

Both of these major reasons for standardisation apply to the additional marketing mix elements for services, but it is particularly the second of these which is most relevant – namely the potential for

increased consistency and control over marketing programmes. Service products are very much people-based and therefore suffer from high degrees of variability. Standardising the marketing mix elements of people, process and physical evidence can help to reduce this problem. Furthermore, by standardising these elements, the international service provider can build a worldwide presence and image.

Whilst the process and physical evidence elements can be standardised relatively easily, it is not always appropriate. Different cultures will give rise to different ideas and approaches to managing the people element of the marketing mix – so. for example, the use of working practices and procedures which are acceptable in one culture may not be in another and some have argued that the very American approach to be found in all McDonalds outlets is not really appropriate in some cultures and can give rise to antagonism.

C. RELATIONSHIP MARKETING

As we have seen, the growth of service industries has prompted businesses to extend the marketing mix to include people, process and physical evidence. Accompanying, and in part, reflecting, this development has been the move towards a new way of looking at the nature of the exchange processes between a company and its customers. The essence of this new way of looking at customer/market exchanges has been the notion that it is increasingly more effective to look at it as a long-term series of mutually beneficial interactions between buyers and sellers rather than simply looking at each as a one-off transaction. A relationship marketing approach seeks to try to shift to maximising beneficial relationships with other parties rather than trying to maximise the gain of each individual transaction.

This new way of looking at the exchange process, together with the attendant changes in marketing practice and the strategies which have accompanied it, is referred to as a "***relationship marketing***" approach.

What is Relationship Marketing?

Relationship marketing questions the classic marketing theory and the traditional four Ps marketing approach, highlighting the importance of co-operation rather than competition.

The contemporary business, it is suggested, should try to build long-term, trusting relationships with customers, distributors, dealers and suppliers. In other words, relationship marketing stresses the importance of looking at and managing the total set of value chain activities involved in the supply and marketing of a company's products. The development of a relationship marketing approach can only be accomplished by promising and delivering reliable and consistent service underpinned by fair prices and agreed procedures between the various organisations in the value chain.

The idea is that with a relationship marketing approach, the respective parties in the value chain, including customers, become more trusting and more interested in helping each other rather than adopting the conventional approach of trying to outdo each other. The ultimate outcome of a relationship marketing approach is the building of a unique company asset, often referred to as a marketing network, which comprises a set of relationships between the company and its customers and the rest of the value chain. Increasingly, the company seeks to try to shift to maximising beneficial relationships with other parties rather than trying to maximise the gain of each individual transaction.

There are a number of reasons why transaction marketing has appeared as a new marketing paradigm.

- The growth of services marketing, with its emphasis on the people elements of the marketing mix.

- The recognition of the sheer common-sense notion of the benefits and advantages of working together with customers and other members of the value chain instead of trying to fight each other.
- The recognition of the cost of acquiring customers and the sense, therefore, of trying to retain those customers which the company currently has. Related to this, is the undoubted value of customer loyalty. Some research suggests that it can cost anything up to ten times as much to gain a new customer as to retain an existing one. Similarly, the lifetime sales value of a loyal customer can be enormous.
- Developments in manufacturing and supply and purchasing procedures such as just-in-time management, zero defects and electronic data interchange systems require a move towards closer relationships and even strategic partnerships between manufacturers and their suppliers.

All of these factors mean that not only business-to-business marketers, where relationship marketing first began to emerge, but also consumer goods marketers are increasingly moving towards a relationship marketing approach.

Developing and Implementing a Relationship Marketing Approach

Developing and implementing a relationship as opposed to the conventional transaction marketing approach requires several changes to be made in an organisation and its marketing approach and strategies.

Perhaps most important in developing and implementing a relationship marketing approach is the need for a fundamentally different perspective on the marketing process. This change in perspective is characterised by the need to consider customers and other members of the value chain as valuable partners who need to be co-operated with rather than protagonists who need to be beaten. In fact, in order for this perspective and approach to work, it is important to recognise that ***all*** parties must adopt this perspective, together with the view that all parties can benefit from a set of mutually beneficial long-term relationships rather than a series of one-off transactions.

Another key factor in developing and implementing a successful relationship marketing approach is the need for everyone in the company, and not just marketing personnel, to be concerned with, and accept some responsibility for, creating customer satisfaction. In turn, this may require changes in organisational structure, staff training and new approaches to evaluating departmental performance. Above all, it requires a change in organisational culture to support the notion of developing long-term relationships with customers.

The implementation of relationship marketing requires effective and two-way communication with the different members of the value chain, including customers. Developments such as improved electronic on-line interaction between companies and their customers and the use of database systems help to facilitate this.

In some companies, relationship management has developed to the extent that they are using relationship managers to manage the relationship between a company and each key customer or customer group.

Finally, developing and implementing relationship marketing above all requires trust and co-operation between the organisation and its customers. Needless to say, this can only be developed over a long period of time and is easily lost if the relationship is abused.

Implications for the International Business

In essence, the requirements for developing and implementing a relationship marketing approach are no different for international as opposed to purely domestic customers and markets. However, once more, the sheer diversity and differences between international markets can make the development of relationship marketing that much more difficult for the international business.

Once again, cultural differences may serve to hinder the development of a relationship marketing approach. For example, in some cultures, sales negotiations are expected to be a confrontational process with winners and losers as the outcome. Similarly, the sheer size of many multinational companies may serve to make it difficult to develop open and close relationships with customers who may be much smaller and hence suspicious of any attempts to deal with them as equal partners.

Another factor which may make relationship marketing more difficult might be problems of communication between the business and different customers. These communication problems may be simply due to physical distance from customers, the fact that there may be several intermediaries and therefore little direct contact with the customer, or simply the fact that language and other cultural barriers serve to impede the communication process.

The international business may need to put special effort into developing effective relationships with international customers. Every effort must be made to ensure effective two-way communication with customers. Again this is increasingly being facilitated by improvements in electronic communication. One approach to developing long-term effective relationships is the development of strategic alliances between the different members of the value chain. This approach formalises relationships between the different parties, although again such formal arrangements are no substitute for the more informal but equally important relationships of trust, developed by giving and fulfilling promises between different parties.

Study Unit 16

Implementation, Evaluation and Control

Contents ***Page***

INTRODUCTION

This study unit covers the implementation of the specific tasks required to meet the objectives of international business strategy, and the evaluation and control of those tasks.

To date, we have been concerned with examining the broader, macro or strategic activities involved in international marketing. So, for example, we have been concerned with the analysis and implementation of broad long-term strategies for international marketing including such areas as methods of market entry, target market selection, the implementation of the overall marketing mix and standardisation versus adaptation issues.

Obviously, these aspects are important inasmuch as they determine the broad overall framework within which the more detailed and tactical aspects of marketing decisions in each individual country are made. Within this broader framework, the international business must meet the needs of customers in their local environment, and within the overall strategic context of the adaptation/standardisation decision, decide the extent to which the elements of the marketing mix will be adapted to meet the specific demands of each market under consideration.

In short, a detailed implementation plan for the marketing activities over the year must be developed, relating to each individual market in which the business operates. We start the unit with a consideration of the way in which such plans are built up and the issues involved. We then go on to examine the key aspects of managing the implementation of the plans and their evaluation and control.

In developing and implementing plans, companies make a series of assumptions about what they ***expect*** to happen. Evaluation and control are concerned with measuring and checking to assess what the results are from the implementation of the plans. They are also concerned with the remedial action that the company should take when, as so often happens, the performance differs from the promise of the plan.

We conclude by considering some consequences for international business strategy of changes in the environment.

A. INDIVIDUAL COUNTRY ANNUAL MARKETING PLANS

A company's overall corporate marketing plan sets the broad objectives and strategies for a company's international marketing operations. At the corporate level, strategic decisions regarding international marketing encompass areas such as the degree of commitment to international markets in the context of the overall business, the selection of regions or countries, the methods of market entry and broad decisions regarding the shape of the international marketing mix, including issues such as the extent of standardisation versus adaptation. Within this context, the annual marketing plan prepared for each country in which a company operates provides the mechanism for implementing overall corporate marketing strategies, whilst at the same time reflecting and accommodating the needs of different countries and situations.

Because the annual marketing plan considers the local environment and customer needs of specific markets, it enables the business to develop marketing programmes which reflect these local environment and customer needs. Essentially, the annual marketing plan enables the marketer to adapt the elements of the mix to meet the specific demands of each market under consideration, including tasks of essentially a more tactical nature compared to those found in the overall corporate international plan. So, for example, within the general framework of a policy set at corporate level encompassing, say, the promotional element of the marketing mix, we wouldn't expect the details of

media scheduling to be exactly the same in every market in which the business operated. Effective implementation requires these more detailed aspects to be considered and incorporated within plans for each country.

The marketing plan helps analyse each individual country's specific requirements and the competitive environment before translating these into specific action programs. Developing a marketing plan for each country ensures that the business has anticipated and understood the following:

- Individual market needs and market trends.
- Competitive market structure and competitive strengths and weaknesses in the market.
- The specific marketing objectives, strategies and tactics that would be most effective in a particular market.
- The required structure and balance of the marketing mix to be used in each particular market.
- The required budget and resource implications.
- The key issues in the implementation process.

Without an annual marketing plan for each market, the business is unable to control and co-ordinate marketing activities across markets, and the overall marketing strategy is unlikely to be implemented effectively.

Elements of the Annual Marketing Plan

Remembering that the organisation should have already established overall corporate and marketing objectives and strategies, a detailed annual marketing plan is required for each market. The main elements of this detailed marketing plan should include the following:

(a) Analysis

For each individual country market, the business should start with a detailed analysis. This analysis should encompass the following:

- Market size and trends.
- Marketing environment and trends – political, economic, social/cultural, technological (SLEPT analysis).
- Competitor and competitive market structure analysis.
- Internal analysis – product portfolio, market share, strengths and weaknesses and current performance levels.
- Customer analysis – needs and motives, segmentation, purchasing patterns and processes, purchasing timings, customs and practices.

All of these elements are important in developing the annual marketing plan for a particular country market inasmuch as the analysis will highlight the local issues, and in particular, the needs of customers in their local environment. Ultimately, the business will possibly be seeing and dealing with customers as individuals and therefore will need to adapt the elements of the marketing mix and program to meet the specific demands of the individual markets under consideration.

Based on this analysis stage, and again against the framework of overall corporate and marketing strategies, the business can now proceed to the next element of the annual marketing plan, namely the production of a detailed SWOT analysis for each market in question.

(b) SWOT analysis

For each market, the business must prepare a detailed SWOT appraisal. You should be familiar with the meaning and use of SWOT analyses and indeed we have discussed this in previous study units. In the context of the annual marketing plan, the SWOT analysis should identify those opportunities and threats which will affect decisions about marketing objectives and programmes in a particular market over the planning horizon of the forthcoming year.

(c) Marketing objectives and strategies

Once again, remember that the objectives and strategies are those that would be pursued over the forthcoming year in each market. This element of the annual marketing plan should encompass:

- The specific objectives and sub-objectives relating to specific products, segments and customers. These objectives should be specific, measurable, actionable, realistic and timed (SMART) and should include objectives for sales, profits and market share.
- The selection of specific market segments and targets.
- The strategies for competing – i.e. the basis of differential advantage to be used.
- The desired product and brand positioning.

(d) Programmes for implementation of the marketing mix

This element of the marketing plan should include detailed programmes for the implementation of marketing activities in a country and, again, should relate to specific products, segments and customers.

Unlike the corporate level marketing plan which is concerned with broad thrusts of strategy and decision-making (such as the selection of country markets, methods of market entry and issues concerning the degree of standardisation or adaptation of the marketing mix elements), at the individual country level, the annual marketing plan will include much more detailed programmes for each element of the marketing mix.

You should remember that individual country annual marketing plans represent an opportunity to meet the needs of customers in their local environment and therefore to adapt the elements of the marketing mix in a more tactical manner to meet the specific demands of each market under consideration.

The implementation element of the annual marketing plan should encompass each of the elements of the marketing mix, including, where appropriate, the extended marketing mix elements for services. The sort of detail included in the annual marketing plan can be illustrated if we consider what the plan might contain with regard to, say, promotional elements. The plan might encompass the following aspects with regard to the promotional programme:

- Detailed promotional objectives for each product/market/customer – for example,. “to increase brand awareness of our brand amongst target customers from its current 10% to 20% within 12 months”.
- Detailed advertising and promotional programmes – for example, details of advertising campaigns, (advertising platforms, media selection and planning, including timing and frequency), advertising research, point of sale material programmes, details of PR and publicity activities (including planned press conferences, press releases, etc.) and details of sales promotion campaigns (including consumer distributor programmes).

- Detailed budgeting requirements and spend patterns for the elements of the promotional campaign.
- Detailed timing and scheduling activities for the program over the year including, for example, agency briefings, timings of press conferences, the distribution of point of sale and other promotional material, etc.
- Detailed evaluation and control activities for the different elements of the promotional mix – for example, advertisement pre-testing research, recognition and awareness tests, etc.

If we take into account the fact that these detailed programmes would be required to be planned for each element of the marketing mix and, where appropriate, for each product, market segment and/or customer, you will appreciate how much more detailed the annual country marketing programme is compared to the overall corporate and marketing strategy plans. Again, we should also remember that this amount of detail is necessary in order to ensure that the needs of customers in their local environment are met, together with the specific demands of each market.

(e) Specification of tasks, responsibilities, costs and budgets

This element of the marketing plan should include detailed outlines of the specific tasks to be performed together with the allocation of these tasks to functions and, ultimately, individuals. Weaknesses in this area of task allocation are, in fact, among the major reasons for ineffective implementation of marketing programmes. Examples of weaknesses in implementation include a failure to communicate with, and, as importantly, agree the responsibilities of, those individuals charged with ensuring that the required marketing tasks are performed.

It is important that those charged with these responsibilities understand what they are, and moreover, have the resources and skills to achieve them. Failure to communicate and agree responsibilities may mean that no-one takes responsibility for the actions outlined in the marketing plan, with the obvious consequences which are likely to result.

In addition to ensuring that tasks and responsibilities are allocated and agreed, it is also important to ensure that costs and budgets have been assessed. In particular, it must be ensured that the required financial resources are available at the right time to implement the marketing plans.

(f) Control and evaluation

The annual marketing plan should include details of expected operating results including sales, profit, financial ratios and other “softer” elements of marketing performance, such as customer service levels, brand awareness, etc. It is against these expected operating results that the business can establish and implement key control standards together with any details of actions required where operating results are not being achieved.

Again, at this level of the marketing planning process, control mechanisms and actions should be detailed – specifying exactly what action will be taken, under what circumstances, and by whom. In the measurement of the annual marketing plan, it is best to have at least quarterly, and preferably monthly, reviews to ensure that plans are on course and also that plans can embody the most up-to-date information on any changes which have occurred.

These, then, are the key elements of the annual marketing planning process and again we can see the need to break down broad overall corporate and marketing strategies into detailed marketing programmes for each country, encompassing specific marketing programmes and activities. As we have also seen, however, implementation means working through, and with, others. Because of this

an important aspect is the "people" element of implementation. We shall consider this aspect of implementation together with several other facets that affect the implementation process and which are in fact related to the "people" aspect in the next section of this study unit.

B. MANAGING THE IMPLEMENTATION PROCESS

Good planning requires different skills from good implementation. Many otherwise excellent international business plans come to nothing because they are not effectively implemented. Effective implementation requires several aspects to be managed effectively and we shall consider four key aspects here.

(a) People management

As mentioned earlier, the implementation of marketing strategies and plans takes place through people. Because of this, the international business must have the necessary skills in managing people. One key skill in this area is the ability to empathise with the views and problems of other individuals. All marketing activities are fraught with uncertainty and risk and can therefore be very stressful, particularly where change is involved as a result of implementing new strategies.

The international business must be aware of these issues and be able to see and anticipate problems as others see them – able to direct individuals whilst at the same time being fair in dealings with staff and allowing those members of staff to feel comfortable in approaching management.

(b) Incentives and rewards

Our second factor affecting the implementation of international business strategies could also be said to be a "people" management issue, in so much as it relates to systems for rewarding, and therefore encouraging or motivating, staff charged with implementation activities.

It is essential that incentive and reward systems in an organisation are geared to key performance standards in a business plan. So, for example, if the marketing plan requires a long-term perspective in terms of, say, increasing market share in a country, it is important not to have incentives and reward systems which are geared to short-term success.

Sometimes, because the development of international business is essentially a team effort, incentives should be group-based rather than individual-based. Incentives should be seen to be fair by all those affected by them and should seek to encourage extra performance.

(c) Communications

Again, related to the "people" aspects, effective implementation depends on good communications throughout an organisation. Staff must be kept informed of objectives and plans and any changes which affect these. Communications should be both horizontal and vertical and should make maximum use of both formal and informal channels.

Problems of communication can be exacerbated in international business due to, for example, geographically distant operations or sometimes an insular headquarters. Regular meetings, status reports, newsletters and so on should be used to communicate. Increasingly, computerised information and decision support systems are helping to facilitate improved organisational communication in international business.

(d) Organisational structures and design

Organisational structures for international business were covered earlier in the course. We saw there that there are several different types of organisational structure for international business and considered their relative advantages and disadvantages.

Different organisational structures have different implications for implementation, with some structures being more effective in this respect. So, for example, more decentralised and flexible organisational structures tend to increase the effectiveness of implementation as they tend to result in more functional communication and teamwork. Sometimes a company may require special organisational structures specifically to implement new international ventures. Such tasks teams may be composed of individuals from different functions of the organisation who are brought together to facilitate implementation.

These, then, are some of the important considerations for the marketer when trying to implement international marketing plans. Failure to manage these aspects effectively can give rise to several problems including, for example:

- Decision making being delayed or deferred.
- A lack of speed in responding to changing marketing and environmental circumstances.
- Poor motivation and high staff turnover.
- Increased conflict and lack of co-operation.
- Increased costs and inefficiency.

C. PERFORMANCE EVALUATION AND CONTROL

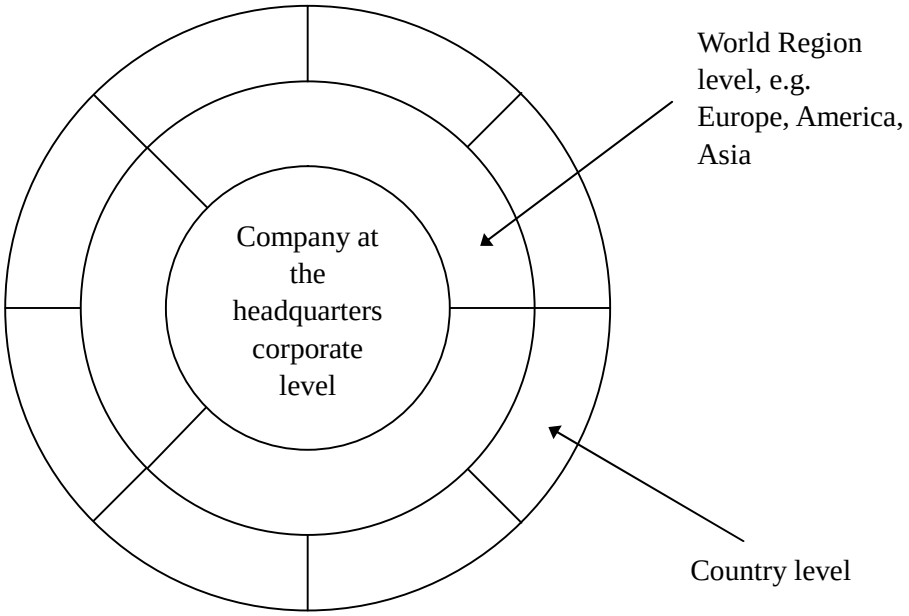
In this section, we start by considering the process evaluating business and marketing performance and in particular some of the more conventional approaches to, and difficulties of, evaluating.

Difficulties in Measuring Performance

It is difficult to arrive at reliable and fair ways to measure performance in the international arena. The reasons for this are as follows:

- Markets are not equal between one country and another. Markets vary considerably in size, in potential, in the variety of competitive forces that exist in the market and in the ways that potential buyers react to changes in the marketing mix.
- The strength of the company in different markets is not consistent. The company will usually have some markets in which it has established a long-term presence. In some markets the company will have used a disproportionate amount of resources. It is, therefore, difficult to disentangle the measurement of current performance from what has happened in the past.
- Performance by the company in a particular market is influenced by various interactions at different levels in the company. This is not a problem for companies with modest levels of sales. However, for large companies with extensive international operations, the interactions are considerable. For some companies there are three or more layers within the company, as shown in Figure 16.2.

Figure 16.2: Layers of the company



We have examined important strategic decisions that relate to country selection, the mode of market entry, and standardisation and adaptation. If we apply these at the three levels, we can imagine that sometimes the managers at a country level might argue strongly for an adapted approach, but that the corporate and regional level might impose a global standard or a regional standard with very little country modification being permitted.

- The evaluation of international performance is significantly influenced by changes in foreign exchange rates. If evaluation is proposed on sales revenue or profit contribution, it is certain that some of the figures that are calculated will merely reflect exchange rates. Obviously, in evaluation it is important to measure the right things. The company has no control over changes in exchange rates. What the company needs to find is a measure that can be used to compare cross-country performance which is largely independent of currency changes.

We can illustrate some of these problems by reference to market share. This is often recommended as a basis for evaluating performance, particularly as it has been used by many companies as an objective of long-term strategic planning in international markets and, indeed, forms the basis of a number of strategy formulation models (for example the Boston Consulting Group Growth-Share Matrix). However, there are problems in measuring market share accurately, including the following difficulties.

- Within country markets it is difficult to find a 100% accurate method. Most markets are measured through marketing research techniques and thus suffer statistical errors. In international marketing there are further problems that relate to the variability of marketing research techniques used in different countries. This will result in different statistical errors.
- Business statistics based on government data might be influenced by incorrect reporting to minimise tax returns, by unhelpful ways in which information is classified in sub-groupings, or by unreliable import/export data. This is likely to be the case if cross-border smuggling takes place.
- Market valuations will be influenced by the foreign exchange problem. This does not affect the size of the market share but it does affect the value of that market share.

- Growth-share matrices are dependent on market growth rate and relative market share data. It might be possible to estimate growth rates without necessarily having reliable data for market size or relative market share.

Evaluation Criteria

It is most unlikely that a company will be able to develop evaluation methods that do not have problems. It is equally certain that relying on just one form of evaluation will provide an incomplete picture of company performance – for example, it is quite usual for short-term sales to increase but for short-term profits to decline, or even become losses, when a new product is introduced, whereas over the longer term, the company hopes to show good profit increases. Thus, companies will vary in the number and range of evaluation criteria used.

The most likely ways in which performance will be evaluated are:

- Comparing performance against the agreed business and marketing objectives.
- Comparing performance against industry averages and against competitors, including (despite all the above comments) market share.
- Profitability – This is the basis that most companies use, at least as one measure of performance, since it is the key measure of performance at corporate level. There are, though, obvious problems in using profitability in a comparative way – foreign exchange variations, the way in which transfer prices have been calculated and different country taxation structures all interfere with accurate inter-company profit performance across country boundaries.

  At a subsidiary company level, companies will use profit return on capital employed, profit return on sales and similar criteria. It is usual for this to be assessed at a pre-tax level, because after-tax includes the tax element over which the local manager has no control.
- Measurements of quality, customer satisfaction and shareholder value. The first two of these are of particular interest to marketing as both quality issues and customer service and satisfaction levels have become more and more important in recent years, both in domestic markets and internationally.

Most measurements will be on a quantitative basis and ratio analysis is frequently employed – for example, in the ratio of marketing costs to sales revenue for each of the different elements of the marketing mix.

Performance criteria that relate to sales and profitability will be communicated through the company accounting and financial control systems. Those that relate specifically to measures obtained through marketing research and marketing will be communicated through reporting systems based on reports that might be monthly, quarterly or half-yearly.

Control Systems

The analysis of performance against the above types of criteria is, as we have seen, more difficult in the international context for a variety of reasons. This is also true of control systems. Of particular importance here are the extra problems that result from geographic distance which reduces the amount of face-to-face contact and gives rise to extra communication difficulty. Furthermore, there are cultural differences that affect the usefulness of control systems. Managers from low context cultures will have more difficulty in interfacing with managers from high context cultures than with managers from similar types of cultural background. This will be further influenced by the local manager/expatriate balance and by the extent to which a real international manager culture has been

achieved. In addition, country-related differences might influence performance to a greater degree in some countries than others. These differences are difficult to isolate.

Control systems are essentially concerned with isolating the causes of performance problems and taking corrective action

At the simplest level, corrective action may be just making an extra effort in implementation – for example, motivating agents or distributors to better levels of sales performance. At another level, more resources might be required. For example, a larger marketing communications budget might be needed, or an extra budget to fund price reductions, or to prevent price increases, which could be necessary if there are unfavourable currency fluctuations. In the short term it might be advisable to reduce the level of profit contribution in an attempt to reduce the price rise impact. At another level it could be that the strategy chosen was incorrect. This would mean that a complete review of the process of analysis, the identification of strategic options, the selection of the preferred strategy and the implementation of the strategy would have to be undertaken.

It has been suggested that strategic control needs to take account of a number of key elements:

(a) Selecting the right evaluative criteria

These need to be as measurable as possible and should be limited to the most important criteria. The criteria need to have short-term and long-term measures and to be benchmarked against key competitors.

(b) Achieving good strategic performance

It must be seen that top management is concerned with performance that directly relates to the achievement of the key criteria. There must be regular review of progress against the criteria. It is essential that balance is discussed between:

- Achievement against different criteria – there might need to be a trade-off between the various criteria.
- Achievement of short-term and progress towards the long-term strategic targets – if attention is focused on the short-term, the end result will be a failure at the strategic level.

(c) Achieving good strategic control

It is important to achieve a high level of strategic planning. If the strategic plan is fundamentally flawed, the control mechanisms will not be able to correct under-performance, and the strategic planning process will need to be repeated. Control needs to take place both through formal and informal appraisals. If things appear to be going wrong, then top management involvement is signalled through rapid intervention.

Methods of Evaluation and Control

As we have seen throughout the different elements of international business, this is a very dynamic and fast changing area. Organisations are constantly looking for ways to improve the effectiveness and efficiency of their activities and this is just as true in the area of evaluation and control as in any other area of business planning. In fact, as we shall see, approaches to evaluation and control in international business are changing dramatically.

There are a large number of specific developments in the techniques of evaluation and control, but the main thrust of change in this area has been two-fold.

- The development of more outward-looking and much broader approaches to evaluation and control which seek to take greater account of both customer and competitor considerations in

the evaluation of business performance and include more qualitative aspects than the more traditional evaluation and control techniques.

- The use of new technology, and in particular information technology which has enabled much more sophisticated techniques of control to be introduced.

Some of the more important approaches in these areas are considered below.

(a) Self-assessment/marketing audits

Increasingly, companies are undertaking full marketing audits. A marketing audit examines every facet of a company's marketing operations with regard to both efficiency and effectiveness. In doing so, the marketing audit acts as both a control and an input to planning activities based on a comprehensive and wide-ranging review of a company's total marketing efforts.

The marketing audit therefore covers responses to changes in the marketing environment and the implications for future opportunities and threats and assesses how valid and relevant the company's objectives and strategies are. Obviously, a marketing audit is a very wide-ranging assessment of a company's marketing performance and needs to be done on a regular, perhaps annual, basis using objective appraisals carried out by the marketing team.

(b) Benchmarking

Benchmarking is essentially comparing a company's marketing performance against the best in class competitors. There are a number of approaches to benchmarking:

- Truly competitive benchmarking compares a company's marketing performance against the best direct competitors.
- Functional benchmarking compares a particular aspect of a company's marketing activities, such as procedures for dealing with customer complaints, against those organisations which are considered best in this area.
- Generic benchmarking is based on comparing marketing practices with the best companies in the world, irrespective of whether or not they are direct competitors.

For the international business, the benchmarking exercise should be done by comparing a company's performance with other international businesses rather than purely domestic ones.

Benchmarking has the advantage of ensuring that a company does not become insular in evaluating its own performance – perhaps judging that it is doing well in terms of its marketing when in fact, compared to the best companies, it is performing badly. So, for example, a company might consider that it is effective in developing and launching new products until it considers its best-in-class competitor who can bring a new product to market twice as fast and at 15% lower cost. Needless to say, many companies that have embarked on benchmarking exercises and have compared their performance against their best-in-class competitors, have experienced a nasty shock.

Since its introduction, the use of benchmarking to evaluate performance has become widespread. The first step in a benchmarking exercise is to determine what constitutes the important measures of marketing performance. In establishing these measures, it is important to look at customer perspectives as to what constitutes effective market performance rather than internal measures of performance such as profits, etc. This understanding of customers' wants and needs is vital to an effective benchmarking exercise. A company can then establish the key factors for success and proceed to measure its performance with regard to these factors against the best practices.

Benchmarking should extend to every facet of the value chain and we should always be looking for ways to improve competitive market performance. For benchmarking to be effective, it is important to have the right attitude towards this process. In particular, it should not be seen and used to expose individual weaknesses in performance in order to punish those responsible. Nevertheless there is no doubt that the use of international benchmarking has helped sometimes insular organisations and marketers to realise that they need much better levels of performance if they are to compete in world markets against the best.

(c) Best practice

The American consulting firm, Arthur Andersen, are credited with the notion of evaluating performance on the basis of best practice. In fact, several studies and techniques use this notion of best practice to evaluate and control marketing activities. The approach is very similar to benchmarking inasmuch as the approach seeks to ascertain those practices which are most influential in determining company success. So, for example, research into best practice has indicated that companies that are marketing oriented, that have good quality and quality control procedures and who provide good levels of customer service tend to have the highest growth and profit rates.

The so-called "Profit Impact of Marketing Strategies" (PIMS) study by the Strategic Planning Institute in America also seeks to establish the key areas for best practice with regard to marketing and profit performance. The idea is that once these best practices are established, together with the key areas which underpin them they can be used by the business to evaluate a company's own performance and ultimately to improve its performance in the market place.

(d) The balanced score-card

This approach to the evaluation of performance is specifically intended to move away from purely quantitative measures, and particularly the financial measures of company performance. Again, important though these financial measures are, as the name of this approach to evaluation and control implies, they are considered "unbalanced" inasmuch as they do not reflect the full range of indicators of business performance. In order to address this imbalance, it is suggested that the organisation identify key performance indicators appropriate to the company and markets in question.

Unlike benchmarking, these performance indicators are not directly taken as being those used by successful competing organisations. Important measures of performance are likely to encompass aspects such as customer retention levels, service levels, perceived satisfaction and so on. Objective measures of company performance against these key criteria are then used, often based on a score-card approach.

(e) The learning organisation

This is not so much a technique of evaluation and control but rather an approach with regard to the control and evaluation process. The notion of a learning organisation centres on the idea that as a result of evaluation, a company should gradually learn to perform better. In other words, the learning organisation would require fewer imposed control procedures if it takes the time and trouble to learn from its past mistakes.

Essentially, the idea is that, eventually, in the learning organisation imposed control procedures will not be necessary. This does ***not*** mean to say that the company will no longer need to measure performance, or indeed that what constitutes effective performance might not change over time, but in the learning organisation the control process becomes one of "self-control" with managers taking responsibility for their own actions and learning to improve over time.

This idea of a learning organisation leads us to consider the notion of "empowerment" in the control and evaluation process.

(f) Empowerment

Again, this is not really a technique of evaluation control, but rather an organisational approach to the control process. It is now increasingly recognised that effective evaluation and control is facilitated by employees being given discretion and authority to take actions as required to improve performance.

A good example would be dealing with customer complaints. By empowering staff to use their discretion and authority, within certain guidelines, customer complaints can be dealt with much more speedily and effectively. So, for example, instead of having a process whereby such complaints are passed through "a complaints system" employees are allowed to deal with the complaint immediately where they feel this will be a better approach.

Obviously, empowerment has to do with organisational powers and procedures but also with the culture which exists in an organisation. In the context of the international business, empowerment as a means of improving performance would suggest a more decentralised approach to decision-making – allowing, for example, employees of subsidiary companies greater discretion and control over important aspects of performance.

(g) The application of new technology

Information technology is changing the process of evaluation and control by opening up new possibilities for information acquisition and analysis. Some of the more important developments in this area are as follows.

- The computer has facilitated the growth of sophisticated data collection and handling systems which facilitate more effective evaluation and control. Using these systems, the international business can increasingly speed up the control cycle. Information is available in real time which enables the business to respond almost immediately to any adverse trends.
- In many companies, computer technology and databases are combined to provide decision support systems (DSSs) which allow managers to manipulate and analyse data at will and act accordingly. Again, such data and decision-making can be done on line. Associated with DSS is the use of increasingly sophisticated software programs to assist managers in their planning and control processes.
- Developments such as Intranets and the Internet have facilitated improved communication both within the company and between the company and the other members of the value chain. This has led, once again, to much speedier on-line decision-making. This is particularly important in international business where distances are greater and traditional methods of communication are sometimes inadequate.

D. PLANNING FOR THE FUTURE

In the development of strategic plans in international business, we have to take account of future change. The strategies that are being implemented now are based on analysis that took place in the past. It is therefore highly probable that some of the assumptions that were used in the formulation of the strategy will prove to be incorrect. In addition, new elements such as new top managers or the opening of new major world markets (as has happened over recent years in Central and Eastern Europe and in China) can mean that new strategies need to be formulated.

"What if?" Questions

You can consider the consequences for international business strategies by playing the "What if?" game. For example, if you took the SLEPT plus C environment framework and asked "What if?" concerning each of the factors, it would set you thinking about a number of possible future scenarios. The following is one approach to this, although you will probably be able to develop some equally plausible scenarios for yourself.

- **"What if" socio-cultural change?**

  If the cultural values that have been significantly different in the past become more Westernised through exposure to, say, US films and television and a market forces type society, will this make it more or less difficult for Western companies to penetrate Asian markets?

- **"What if" legal change?**

  If Islam becomes a more dominant religious force in the world, will this influence the relative importance of Islamic law in adjudicating international trade?

- **"What if" economic change?**

  If China continues its rapid economic growth, will it become a fourth dominant market in the world market along with the US, Japan and Europe? If this happens, in which markets will Chinese companies come to dominate? Which markets in China will be significant opportunities to companies from other countries?

- **"What if" political change?**

  If countries in various parts of Africa, Asia and South America become more capable, through political change, in the economic management of their countries, will this create new opportunities for international business managers?

- **"What if" technological change?**

  If the pace of technological change increases, will smaller companies be able to survive? If technological innovation becomes concentrated on Japan and the US, what impact will this have on the international business strategies for companies in Europe and in other parts of the world?

- **"What if" currency change?**

  If the Japanese yen continues to appreciate against the US dollar, what consequences will this have? Will it make it more and more likely that foreign direct investment will be from Japan into the US rather than the other way round? Why should this be so?

  Will the European single currency make exporting more convenient to Europe? Will it be more beneficial to other European companies or to non-European companies?

What Changes will be Necessary?

In a world in which major change seems likely, but will be difficult to predict with consistent accuracy, international business managers will have to improve their whole strategic approach to gain sustainable competitive advantage.

Analysis will need to improve to provide a better and a quicker assessment of customer buyer behaviour. Marketing research techniques will need to improve and international business managers will need to become better at using marketing research. Market segmentation is likely to evolve across country boundaries. International marketing information systems will need to cope with large flows of information from some countries and very poor flows of information from other countries.

Managers will need to become more international to minimise the problems caused by self-reference criteria.

The development of strategies will need to take account of different types of option. For example, joint ventures and strategic alliances have been popular means to speed the process of international expansion and to share the costs of major new product development. It is not certain how enduring joint ventures and alliances will be. If they break up, what new structures will be put in their place? If strategic alliances are used, how will this influence the evolution of worldwide competition?

It is likely that companies will have to take particular account of how to gain and sustain competitive advantage in situations in which technological advantages will be swiftly countered. Differentiation through excellent customer service, through creatively appropriate marketing communications and through innovating effectively will become very important.

As some companies become more and more significant in the world marketplace, the need to develop and implement competitive strategies that are co-ordinated across country markets will become more important.

In the implementation of international business strategies, companies will need to develop a more international culture. This will mean more experienced, truly international, international managers. The equidistant manager might be a long way off, but certainly the ethnocentric manager influence needs to be substantially reduced.

To be successful in the world marketplace, international businesses need to balance the financial implications of their strategic options and of the implementation of their preferred option. We have looked at the financial implications as we have moved through the international marketing strategy process. In the future, the likelihood is that the increased scale of international operations will make the appraisal of financial risk and return even more important than it currently seems to be.

Study Unit 17

Finance and International Business

Contents ***Page***

INTRODUCTION

As we have seen, the development of international business usually follows a series of stages, from exporting to full global operations. These stages also equate with the options for market entry. Each of these involve a different financial commitment and a different set of financial implications.

The various levels of international involvement will be a reflection of a number of factors:

- the objectives of the business – for example, to extract the maximum possible profits from a subsidiary as quickly as possible, or to develop a lasting presence in the country to the mutual benefit of all parties;
- the conditions applying in the particular country – for example, there may be restrictions on the type of investment allowed, or the level and type of funds which can be repatriated by a parent company; and
- the level of risk attached to business operations in the country. This is a significant factor and we shall examine it in some detail in the next unit. However, it is worth noting here that the risk associated with committing funds to international business varies with the type of international involvement.

In this unit we shall examine the financial strategies associated with developing international business in the light of the above factors.

Note that, in certain areas, we shall be covering similar ground to that in the Corporate Finance module and the material here will repeat some of the concepts and considerations examined there.

A. FINANCE AND THE DEVELOPMENT OF INTERNATIONAL BUSINESS

The sequential nature of international expansion tends to follow a set pattern.

(a) Exporting

This is the lowest risk option from the firm's point of view as it involves no upfront capital outlay. The risks relate to payment for the goods themselves, which we shall looked at in the next section. Exporting also allows a firm to "test the water", so to speak, by learning more about the market it is dealing with in terms of language, culture, business practices and so on.

(b) Licensing

Under this form of involvement a foreign firm manufactures the home firm's goods and in return the latter receives royalties or other forms of payment. Again, the level of capital investment is quite low, but on the downside returns may also be correspondingly low and there is the added complication of maintaining quality standards. A further consideration is that the licensing of a firm's products can set up foreign competition which could well close the market to direct exporting.

(c) Technical support or management contract

This can be viewed as an extension of licensing and is an attempt to impose some sort of control on the foreign producer by having a contract to supply technical or managerial know-how, spare parts, etc. Further fees can usually be earned as a result. Technical or managerial support is also applicable where no licensing agreement exists and can be a useful route into an overseas market.

(d) Franchising

An entity in the United Kingdom owning patents or trademarks may want to exploit them abroad through a local company. This can be done by granting the local entity a licence under an agreement. The UK company would, under the agreement, ensure that their quality standards are maintained.

Franchising operates where the licensee is to trade under the marketing image of the holder of the patent or trademark, and under the name of the franchiser. Although the franchisee operates under the name of the franchiser, the outlet in the foreign centre is owned by the former, who takes the capital risk locally. Some measure of control is usually maintained by the franchiser over the activities of the franchisee by the terms incorporated in the agreement signed by both parties.

(e) Strategic alliance

In recent years the strategic alliance has been prevalent in the motor industry (e.g. Rover and Honda) and it is a partnership which is advantageous to both parties. It often takes the form of swapping technical know-how from one party, in return for an entry into the other firm's market.

(f) International sub-contracting

This is applicable to those instances where a firm may have won a contract for a large capital project part of which is best carried out by a firm based in the foreign country. If there are several sub-contractors in different countries this form of agreement can become complex to control.

(g) Joint ventures

This may take a number of different forms.

- ***Joint organisations***

  A partnership is defined in the **Partnership Act 1890** as the relationship which subsists between persons carrying on business in common with a view to profit. Under English law certain rules apply to partnerships and, in the main, a partner can bind the firm, and all partners (except within limited liability partnerships) are liable for the debts of the firm.

  In dealing with joint organisations and ventures the relationships and liabilities between members will differ from those that apply within partnerships. Members may agree on a loose or close relationship according to the needs and the purpose of the joint operation.

- ***Joint marketing organisation***

  There are various forms of joint marketing organisations but here it is sufficient to say that the main objective is that various manufacturers agree to share the cost of maintaining an exclusive representative or company abroad, which is responsible for marketing the goods and manufactures of the companies represented in the chosen area.

- ***Consortia***

  In order to be competitive when bidding for a contract abroad, say to build a major plant or project, two or more companies may decide to form a new company under the **Companies Act**. This new company will bid for the contract and if the bid is accepted will be responsible for the completion of the work. Some guarantees may be called for from participating companies and such details and responsibilities should be agreed at

the time of formation of the new company. Sometimes the arrangements are less rigid and the result is a relationship somewhat similar to that between members of a partnership.

- ***Joint venture***

  Companies trading abroad may wish to be involved on a business basis with a local company in the country to which their goods are directed. The two companies will enter into an agreement to cooperate. Through this agreement the goods of, say, a British company may be produced or assembled in the foreign centre from parts exported from the United Kingdom, possibly through a joint venture company. The agreement will state the conditions and terms under which the joint venture will operate – the input required of both parties, the arrangements regarding management; and general details covering the particular operation including the distribution of profits. The form of contract must be drafted by experts, who will be aware of the objectives of the venture and the wishes of the parties to the agreement. Having agreed on the terms of the cooperation agreement, consideration must be given to the legal form the joint venture will take.

  The form of the venture should be flexible and possibly a private limited company will suit both parties. However, the joint venture company or entity may have to be incorporated in the foreign centre and its form may be dictated by the foreign government. The law relating to the foreign country, including any restrictive trade practices must, of course, be complied with.

  Joint ventures have become of particular importance in trade with China and East European countries. Some of these countries allow profits to be shared, but after a term of years all subsequent profits must then go to the local company and sole control then rests in the foreign country.

  Economic interest groups (e.g. European Economic Interest Groups) are organisations which aid parties to joint ventures to cooperate and overcome differences in culture and legislation.

(h) Wholly-owned subsidiary

This is, of course, the final stage and is usually achieved by the acquisition of an overseas entity. The advantage is that it provides instant access to the chosen market, but against this is the high capital investment required and the possibility of expropriation of the assets by the foreign government.

Factors Affecting the International Expansion Decision

It is often the case that the move into international markets is a sequential one, but one which can be short-circuited depending on circumstances. Some of the factors affecting the decision are:

- **The size and scope of the company concerned.** The larger the entity the more likely that it will use its expertise and resources to acquire an overseas subsidiary rather than begin by exporting.
- **The level of international experience gained to date.** With little or no experience it makes sense to begin by exporting to an overseas country thus incurring the minimum risk.
- **Financial, managerial and technical strengths.** The considerations here are similar to the first point. The larger a firm is the more likely that it will have the necessary internal expertise to make a direct acquisition successfully.

- **Industry and market conditions.** The condition of the overseas market may be such that it is considered too volatile to enter, in which case a strategic alliance may be the only option.
- **Availability of resources and their costs.** Does the firm have sufficient internal resources or does it need to borrow or issue new equity and what is the cost of such funds?
- **Permissiveness of environment.** This is very much related to the attitude of the overseas government to investment from foreign firms.
- **Risk**. This includes political risk and currency (exchange rate) risk which we consider in the next unit.

Foreign Direct Investment

There are several reasons why a company may grow via foreign direct investment (FDI) and become a multinational, and often in making the decision financial considerations are outweighed by strategic reasons. The common reasons quoted for FDI are listed below, but you should note that there is often more than one reason why a firm may decide to invest overseas.

- The provision of raw materials such as oil and minerals – many MNCs base part of their operations at the location of their raw materials, for cost or logistic reasons, or in order to comply with the political and legislative wishes of the host government.
- The provision of cheap and productive sources of labour is a reason given for many MNCs locating in the Far East and Mexico.
- Location in the market for the company's goods – for example, several Japanese car firms have located in Europe in order to supply the EU market.
- Location in centres of knowledge – for example, several Japanese and European companies have purchased firms in the US in order to gain access to technological knowledge in the field of electronics, and Microsoft's plan to establish facilities in Cambridge is an example of a firm investing in Britain for this reason.
- To permit diversification opportunities not available in the company's domestic markets.
- To allow growth if there are limited opportunities for the firm "at home"; such growth can take the form of diversification, horizontal or vertical integration.
- For companies based in countries with unstable or unpredictable political regimes FDI may be a way of ensuring safety from interference in, or expropriation of, their business. Such fears led to FDI in Australia and North America by Hong Kong-based firms prior to its repatriation by the People's Republic of China.
- To avoid import controls or to obtain grants and concessions.

The most common forms of investment abroad are:

- The takeover of, or merger with, a firm already established in the target country. This option has the same advantages and disadvantages as a "domestic" takeover – established markets, production and distribution facilities, but often poor performance, financial status and management.
- Joint ventures with an overseas partner local to the area where investment is to take place, either for a fixed period of cooperation on a defined number of projects, or a continuing long-term joint-equity venture. Joint ventures are common in the Middle East and Japan where legislation prevents or makes difficult 100% foreign ownership of firms. It is also becoming

increasingly popular in areas with high research and development costs such as the aerospace and car industries.

- Firms may start up overseas subsidiaries or branches from scratch. This route reflects the same advantages and disadvantages as domestic start-ups with the additional problems/opportunities that may occur as a result of differences between the two countries concerned.

B. FINANCING INTERNATIONAL TRADE

Working capital finance requirements for overseas trade are likely to be greater than for solely domestic trade because of transport time, administrative delays and perhaps longer credit terms (90 days from shipment or 60 days from receipt).

Before considering financing methods themselves, it will be useful to briefly review the terms under which international trade transactions conducted.

Terms and Methods of Payment

The most common form of settlement for the cost of a trading transaction is by means of a ***bill of exchange*** (also called ***trade bills***). This occurs when the seller draws a bill on the buyer asking them to pay, on a certain future date, the price of the goods supplied, which is then accepted by the purchaser (by signing and returning it to the seller). The purchaser is thus formally acknowledging his debt to the seller. The seller can then use the bill of exchange as security in order to obtain money from the seller's bank.

A bank may also agree to accept a bill from its customer in exchange for an agreement that the customer will repay the bank. The cost for arranging this finance is the discount (i.e. the full amount of the bill is not advanced). The more secure the bill (e.g. from a bank as compared to a trader) the "finer" or lower the discount.

Note that a bill of exchange is a method of facilitating payment and could therefore be used in several of the different ways in which payment for transactions may be effected.

(a) Open account

The exporter ships the goods and any documents of title direct to the importer. Payment is made by the importer in accordance with invoice terms, the exporter bearing the risk of non-payment.

(b) Documentary collection

The exporter ships the goods and sends the documents of title through the banking system. There is a collection order which instructs the overseas bank regarding release of documents to the buyer. The exporter can instruct that the documents are either released against payment or against acceptance.

Open account trading status reports should be taken on the buyer, and insurance can also be taken out, if required.

(c) Documentary letters of credit

A documentary credit is a guarantee by the buyer's bank (the issuing bank) that bills of exchange drawn by the exporter will be honoured, provided the credit terms have been fulfilled.

If the credit is irrevocable, it can only be modified or cancelled with the agreement of all parties.

Confirmed credits are ones which contain the additional guarantee of a bank in the exporter's country to honour them, should the issuing bank default.

Documentary credits have an additional security over documentary collections. Banks deal in documents not in goods and, as the seller must comply with the instructions issued by the buyer's bank, the seller will check those instructions before shipping the goods and, if he can comply with the instructions, he will get his money. Failure to comply with the instructions as detailed will mean that the seller's bank must refer to the buyer's bank and get permission to effect payment.

(d) Advance payment terms

The most advantageous method of payment from an exporter's point of view is to receive cash for his goods before shipment. This method affords the greatest protection and allows the exporter to avoid tying up his own funds. Although less common than in the past, cash payment upon presentation of documents is still widespread.

Cash terms are used where there is political instability in the importing country or where the buyer's credit is doubtful. In addition, where goods are made to order, prepayment is usually demanded, both to finance production and to reduce marketing risks.

Finance for Exporters

Delays in receipt of payment for goods sold overseas can seriously affect a company's cash flow, eventually reducing profitability. Banks and other organisations have therefore developed a wide range of finance facilities to assist exporters in financing their international business. Export credit can be split into two categories.

- ***Supplier credit*** – where the exporter sells goods to an overseas buyer on credit terms (for example, 30 days) and then obtains finance from a bank to cover the period of time between shipping the goods and receiving payment.
- ***Buyer credit*** – where the bank provides finance directly to the overseas buyer and the exporter receives payment upon shipment of the goods.

Payments made by banks in respect of various export finance schemes are paid either:

- ***With recourse*** – where the bank has the right to claim reimbursement for sums advanced to the exporter, in the event that the buyer does not pay.
- ***Without recourse*** – where the exporter is not liable to repay finance received from a bank, if the buyer defaults.

If the exporter is cash-rich, he may be able to finance export sales from his existing bank balances. However, outlay can be considerable and, if credit terms are allowed to the buyer, the cost of raw materials, manufacturing and shipping will not be recouped in the form of the buyer's payment for some time, and additional funding may be required. The following are the normal method of obtaining such funding.

(a) Bank overdraft

Probably the easiest way of financing export sales is by use of an overdraft facility agreed with the exporter's bankers, though exporting companies are unlikely to use this method to finance all their exports, since other forms of finance which are specifically designed for export credit are available at lower cost.

(b) Advance against bills

This is short-term, with-recourse, finance obtained by an exporter who draws a bill of exchange, under the terms of the export contract, on the overseas buyer. The exporter presents the bill of exchange to the bank, which advances an agreed percentage of the face amount of the bill to the exporter and undertakes to present it to the buyer for collection. The bank charges a fee for this service, together with interest at a variable rate for the period of the advance.

(c) Negotiation of bills

This means that the bank buys the bill from the customer. The customer receives the face amount of the bill immediately. The bank sends the bill of exchange and the related shipping documents to the buyer's bankers for collection and reimburses itself upon receipt of the proceeds, at the same time recovering its collection charges and interest for the period involved.

A negotiation facility must be specifically agreed with the exporter's bankers, and funds made under this facility are on a with-recourse basis. Recourse is available to the banker upon dishonour of the bill, the charges and interest for this being fixed at the time of negotiation.

(d) Discount of a bill

Banks are prepared to discount bills of exchange which can be either:

- Drawn by an exporter on a buyer and accepted by that buyer; or
- Drawn by an exporter on a bank, under a letter of credit, and bearing a bank acceptance.

Bills are discounted with recourse to the customer and the discounting bank pays the face value of the bill less the discount charge which depends partly on the length of time the bill has to run to maturity and partly on the rate of discount which is usual for that type of bill. Finer rates are available for bills bearing a bank acceptance than for those accepted by an unknown or doubtful buyer.

(e) Acceptance credit facility

This is a facility offered by banks for large companies with a good reputation. The company draws bills of exchange on the banks, generally for 60, 90 or 180 days, denominated in whichever currency most matches the needs of the company. The bills can be drawn on, as and when required, throughout the length of the agreement, which can be up to five years, provided the credit limit is not exceeded. The bill is then sold in the discount market and the proceeds passed to the company (less the bank's commission). At maturity the company reimburses the bank the full value of the bill, and the bank pays the holder of the bill.

A major advantage of acceptance credits is that they can be sold at a lower discount than trade bills. The cost of them is also fixed, allowing for easier budgeting and may be lower in times of rising interest rates than that of an overdraft. The credit is also guaranteed for the length of the agreement, which is not the case with an overdraft.

Where goods are involved the bank generally has control over the documents and the goods.

An acceptance credit facility is normally only used by larger companies. Be careful not to confuse it with a documentary acceptance credit.

(f) Documentary acceptance credit

When an exporter presents documents under a confirmed irrevocable letter of credit to the confirming bank, he can obtain ***immediate*** finance, provided the documents comply with the terms of the letter of credit. The confirming bank will accept a term bill of exchange which can

be discounted by the confirming bank, or the exporter can regain possession of the accepted bill and discount it with any bank for cash. Discount fees are paid by the exporter unless, under the terms of the letter of credit, the applicant/overseas buyer is responsible for such costs.

(g) Merchant bank finance

A merchant bank could provide most of the facilities already mentioned but, in addition, it can offer an accepting house acceptance facility. The exporter again hands over the documents as collateral security and draws a second bill on the accepting house for up to, say, 75% of the collection value and with a tenor slightly longer than the export bill, to allow receipt of proceeds before the accommodation bill matures. The merchant bank accepts the accommodation bill and discounts it in the market. For protection against risks, the merchant bank would expect not only to have control of the bill and the documents it is handling for collection, but also additional safeguards such as insurance cover.

(h) Factoring

Factoring is a without recourse form of finance and the factor will only enter into an agreement with an exporter after satisfactory reports have been obtained as to the exporter's standing, the reliability of the overseas buyer, and trading conditions in the foreign country.

There can be many ***advantages*** for the exporter in employing a factor to deal with his debt collection:

- Credit risk is eliminated under the non-recourse agreement.
- There is no need for credit and political risk insurance.
- There is no need to take out forward exchange cover.
- Immediate financing is available on approved invoices, if required.
- There are no losses through bad debt.
- There is a reduced staffing requirement, since accounting, debt collection and the sales ledger are handled by the factor.
- It gives the exporter the opportunity of trading on "open account" terms, but with the security of also using more traditional instruments, such as letters of credit and bills of exchange.
- There is no need for any other source of status reports and credit information.
- Experienced credit managers are on hand, whose knowledge of language, local laws and trading customs are invaluable. A factor with established contacts is able to assess foreign buyer's creditworthiness more easily and thoroughly than the exporter can from his own sources.

However, the ***disadvantages*** of factoring must also be considered:

- Costs – these vary, depending upon the extent of the service required by the exporter: administration of the exporter's exports sales ledger; credit protection; financing.
- A factor is selective in choosing clients and debts.
- A factor may set an overall turnover limit for the exporter.
- A factor may set a limit on the amount owing at any one time by any one buyer.
- Terms may be limited to 120 days.

Factors lend or provide finance against debts which are already approved on the strength of the creditworthiness of the overseas buyer. The exporter's own bankers may be prepared to effect an introduction to a factoring subsidiary of the bank. An exporter considering employing the services of a factor should always consult his bankers, since factoring can affect the value of a lending banker's security.

(i) Export house finance

Export houses can be grouped into:

- ***Export merchants***

  These buy goods in their own right from suppliers and export them to their own buyers abroad for cash – usually within seven days. A merchant can therefore eliminate credit risk for the exporter, and transform the deal into the equivalent of a domestic cash sale.

- ***Export agent***

  An export agent acts as agent for the exporter, and the contract relationship between the buyer and seller is maintained. The exporter receives payment from the export agent upon shipment of the goods, and the overseas buyer is allowed a period of credit by the agent, which is provided from the agent's own resources.

- ***Confirming house***

  A confirming house acts as agent for the overseas buyer, places an order with the exporter, and accepts a usance bill from the buyer which can be discounted at a fine trade bill rate. The buyer therefore receives a period of short-term credit, and the exporter need not be concerned with credit risk , since this is the equivalent of a domestic sale.

- ***Export finance house***

  This will provide non-recourse finance to the exporter under the terms of the export contract and agree credit terms to the buyer. Like the factoring company, it will deal with obtaining a credit assessment of the buyer and will relieve the exporter of the need for credit/risk insurance but it can arrange such, if required, or accept an assignment of a policy, as the banks do.

(j) Instalment finance

Some finance houses can arrange hire-purchase finance, covering a wide range of consumer and capital goods, through a network or credit union of associates in both buyers' and sellers' countries.

The exporter will gain satisfaction from the arrangement (which is without recourse to himself), as he receives immediate payment, while the buyer receives deferred terms under a hire-purchase agreement. It is a relatively costly plan, and it may not work where there are exchange control restrictions or other monetary regulations.

(k) Leasing

An exporter sells the equipment to a leasing company, which then leases it to an overseas hirer. The exporter receives payment without recourse from the leasing company – usually after the equipment has been shipped and installed at the hirer's premises.

There are two main types of lease seen in the international context:

- ***Cross-border leases***, which are made directly from the leasing institution (often subsidiaries of major banks) in the exporter's country to the overseas buyer.

- ***Local leasing facilities***, which may be available, perhaps, through overseas branches or international leasing associations.

Both types of arrangement may be eligible for insurance cover. Where contracts are arranged between the leasing company and the foreign buyer, the insurance will be undertaken by the lessor. Here the exporter will have no risk, having sold the goods direct to the leasing company. In those cases where the exporter arranges his own leasing deals direct with the foreign buyer, he will himself be able to obtain cover.

(l) Forfaiting

Forfaiting is a means of providing exporting companies with trade finance on a without recourse basis, while their overseas buyer acquires a period of credit of up to seven years.

When forfaiting an exporter is giving up the right to claim payment for goods delivered to an overseas buyer. These rights are surrendered to the forfaiter (normally a bank, finance house or discount house) in return for cash payment at an agreed rate of discount.

Any type of trade debt can be forfaited and these debts can be in any form but they are usually either:

- A bill of exchange accepted by the buyer, or
- A promissory note issued by the buyer.

The forfaiter will calculate the discount rate, taking into account:

- The currency used
- The buyer's credit rating
- The credit-risk factor for the buyer's country

The discount rate is calculated as a margin above prevailing eurocurrency market rates for the period of credit and it varies in line with those rates, since this is the main source of funds which forfaiters tap to provide finance to exporters. Trade paper is discounted in any fully convertible currency, although US dollars, Swiss francs and Deutschmarks are usual, since these are the main eurocurrency market currencies.

A forfaiter will not finance a trade debt without the guarantee of a known international bank, although finance will be considered in respect of bills of exchange accepted, or promissory notes issued, by a first-class buyer, such as a government agency or a major multinational company.

Advantages of forfaiting for the exporter include:

- Forfaiting offers 100% finance on a without recourse basis and at a fixed rate, thereby enabling the exporter to build finance costs into the contract price. Finance is off-balance sheet, thus preserving existing bank credit facilities.
- In addition to removing interest risk, forfaiting also eliminates exchange, credit, political and transfer risks.
- Forfaiting is flexible, there being no distinction between types of goods and services and no constraints on origin.
- Forfaiting finance can be arranged very quickly, and documentation is brief and relatively simple.

- Forfaiting transactions are rarely published, and this aspect of confidentiality is often attractive to exporters.
- The ability to offer forfaiting in a tender may be necessary in order to remain competitive.

Disadvantages of forfaiting for the exporter include:

- Despite the greater degree of competition among financial institutions for forfaiting business, which has brought interest margins down, forfaiting tends to be relatively expensive.
- Forfaiting is generally limited to the major currencies, and forfaiters will not accept countries where too great a risk is perceived. Similarly, the forfaiting institutions will only accept the aval of a limited number of banks considered suitable.
- The exporter normally has a responsibility to ensure that the debt instruments are validly prepared and guaranteed.

Finance for Importers

The importer must also have adequate finance available to enable him to purchase goods either for immediate resale or for processing prior to resale. Banks and other financial institutions have developed various products to make sterling and foreign currency financing available to importers.

These are similar in nature to the methods available to exporters and include the following.

- **Bank overdraft**

  In most cases an importer would not be able to finance all his purchases from an overdraft facility, since this is an expensive source of finance. Overdraft facilities may be secured or unsecured, depending on the financial standing of the importer.

- **Bank loan**

  Bank loans are available to companies in both sterling and foreign currency. Some form of security, however, would be called for by the bank.

  Importers may take advantage of favourable interest rates by borrowing in foreign currency, especially if they are able to make repayment of the loan from receivables denominated in the same currency. Eurocurrency loans are available for large national or international projects.

- **Term documentary letter of credit**

  The importer can ask his bank to open a documentary letter of credit in favour of the seller, under which drafts are drawn, payable not at sight but at usance, i.e. 30, 60, 90, 120 or 180 days after sight. The exporter can readily discount such bills and get spot cash because of the standing of the accepting bank. The importer, however, does not have to provide cash until the maturity of the bill. As an alternative, where a documentary letter of credit is not considered appropriate, the importer's bank may simply add his "*pour aval*" endorsement to the bill. This guarantees to the drawer that the bill will be paid at maturity.

- **Produce loan or merchandise advance**

  A produce loan is made by a bank to an importer to enable him to pay for goods which he has contracted to buy. The goods are the security for the loan, which is repaid from the proceeds of sale.

Produce loans are granted for short periods only – long enough for the importer to be able to resell the goods and repay the loan with the proceeds – usually between seven days and three months.

- **Acceptance credits**
- **Export credit**

  Export credit agencies have been established in several countries, to encourage the export of goods and services. The exporter can obtain credit facilities from these agencies at fixed and preferential interest rates, which enables credit finance to be made available to importers in other countries.

  Rates of interest and lengths of credit terms are agreed by members of the Organisation for Economic Cooperation and Development (OECD) and these terms, which are offered by most national credit agencies, are reviewed on a regular basis.

- **Confirming houses**

  The importer can receive short-term credit from the confirming house, to which he must pay a commission for the service provided.

In addition to direct financial assistance, banks also provide a range of further services. The principal service is effecting payment:

- Where open account or payment in advance terms are used, banks will effect payment by means of money transfers, telegraphic transfers, the SWIFT system, or by draft.
- Opening of documentary letters of credit, including back-to-back and transferable letters of credit.
- Selling foreign currency to the importer to settle his purchases, both on the spot and on forward currency markets.

In addition, they will also obtain status reports on prospective suppliers, provide advice and practical assistance in complying with exchange control requirements, import licences, documentation, etc., secure travel facilities for importers seeking to make contacts overseas and assist in finding suppliers via the bank's correspondent networks, and arranging introductions.

Countertrade

Countertrade can be defined as a trading transaction whereby export sales are dependent on the exporter receiving imports, in one form or another, from the buyer. We have already considered this as part of the examination of pricing in Unit 12.

C. FINANCE AND THE MULTINATIONAL COMPANY

The Role of Subsidiaries

As a general rule, the subsidiaries of an MNC will be expected to earn a profit for their parent organisation, and their financial policies and planning will be based on the objectives and interests of their parent. In theory each subsidiary should be capable of financing itself, whilst continuing to make a profit for the parent company, although this may not always be possible. New operations in a foreign country may mean that the company does not generate a satisfactory return in the early years. In such circumstances the parent may have to support the company by the provision of cash or guarantees.

Nonetheless subsidiaries do, in general, stand on their own feet and provide their own capital from their own generated profits.

Countries which receive foreign investments have to accept that foreign subsidiaries of MNCs will become net exporters of cash in the longer term. One of the main benefits to the host country, beyond the creation of jobs, arises from the payment of taxes and customs duties. Generally, too, the level of industrial investment will be increased, and the balance of payments of the host country will be improved as the MNC starts to export to other parts of the world.

Benefits are not always one-way. Decisions to transfer reserves out of the host country may not be in its best interests, and pressure may be brought to bear by the government of the home country of the MNC. An example of this is when companies in a host country are required to limit their import of capital and to send home high proportions of their foreign earnings.

Obtaining Funds Internationally

MNCs often obtain their funds from the international markets, although working capital needs of individual subsidiaries may be raised locally. Because of the scale of operations there is rarely any difficulty in raising funds, but there may be a local limit to the amount of borrowings which the host country is prepared to allow.

A company needs to consider the cost, timing and speed of overseas loans, as well as the size of loan and the currency the borrower wishes to obtain. The security required should also be borne in mind, as should any potential to reduce exchange rate exposure.

Treasurers should not forget that interest rate parity can show how, when considering exchange rate movements, the real cost of interest rates in different currencies are similar. However sometimes, because of market imperfections, there can be opportunities to obtain cheaper loans in alternative currencies.

A common method of financing an overseas subsidiary is to finance its fixed assets with a long-term loan in the host country's currency; this allows the repayment of the loan using the profits generated in that country. This is known as ***matching of assets and liabilities***, and is a method used to reduce exchange rate risk.

MNCs often use international sources of funds – for example, eurobonds, eurodollars and overseas capital markets – to finance both themselves and their subsidiaries. The borrower must be of high credit standing and must need large sums of money, as these markets are for the international gathering of capital resources and are not aimed at the smaller organisation.

When considering a eurocurrency loan, firms need to consider likely fluctuations in exchange and differential interest rates creating an ***interest rate trap***, where a lower interest than that achievable on the domestic market becomes more expensive in both domestic and foreign currency terms due to changes in the exchange rates.

Arbiloans (international interest arbitrage financing) are variations on currency swaps which may be of use in financing MNCs. A subsidiary based in a low interest rate country borrows and converts at the spot rate to its parent's currency. The parent then agrees to repay the loan at the term end and at the same time buys a forward contract. This is common when a parent faces credit restrictions and high interest rates.

In deciding the financial structure of an overseas subsidiary the parent must consider a number of features:

- the level of gearing the subsidiary should have, and from what source;

- how much equity should be placed by the parent in the subsidiary and how much from outside (and from what sources); and
- the level of reserves and working capital the subsidiary should aim for.

These choices will be determined by political and legal restrictions in the parent's country and the host country and the expected level of permanence of the investment. For a longer-term investment, long-term sources of funds such as equity would be used in preference to short-term funds such as trade credit – which would be used for a short-term investment.

Moreover the firm, in common with all organisations, needs to consider the cost of capital, including the cost of local finance. Whilst the factors affecting a domestic firm when deciding on its capital structure also need to be considered by an MNC, the decision is made somewhat harder by the greater choice of capital available from international capital markets, taxation and other legal restrictions (such as on dividends or the flexible repayment of loans to parents) in the various countries in which the MNC operates, as well as potential subsidies from host governments.

A further factor to consider is that subsidiaries may have a guarantee from the parent company, thus permitting a higher level of debt than would otherwise be the case.

Governments will often wish to encourage MNCs to establish operations in their country, thereby creating wealth and increasing employment. This is often achieved through grants, subsidies, favourable loans and guarantees. Whether help is given to a business applying for such help will be dependent upon whether its proposals qualify.

Performance Measurement in Divisionalised Companies

A special relationship exists between two companies which are associated or commonly owned, which may carry on trade with each other, and over which some central authority or "head office" wishes to exercise control.

Since, as a division within a group, the results of perhaps formerly independent companies are now submerged, the group's central management has to monitor its divisions' performance at acceptable levels, without recourse to the market as a barometer of achievement.

The central or corporate management obviously wishes to exert control over its divisions. It is claimed that centrally-imposed systems of budgets are restrictive, and that, by constraining the divisions to some pre-set level of performance, monitored (and sometimes set) by the central management, the profit-motivated, local management creativity of the entrepreneur is diminished.

(a) Cash flow

In the majority of groups, cash is controlled centrally rather than at divisional level. Inter-divisional indebtedness is then passed through a system of current or suspense accounts. The problem is whether divisions should be charged for their level of indebtedness to central control. If so, is this unfair to the division which does very little external business but trades mostly with fellow divisions and regularly has to seek central funding?

(b) Common facilities

Certain facilities are obviously best not duplicated, especially where more than one division operates from the same premises – for example, telephone systems, buying activities, personnel function, financial management, etc. The sharing of such facilities by divisions leads to the problems of sharing the costs, the cash flows, the supervisory responsibilities and other similar problems which are almost inevitable where no one employer (division) controls the facilities.

(c) Measuring management success

Clearly, the all-embracing measure of performance is ***profit***-related in meaningful terms to investment used in creating that profit. But does managerial success bear an exact correlation with profit? Managers can manage successfully, and the result may still not be profitable. The fact that they managed as well as they did might have kept the loss under reasonable control. Alternatively, bad management might still produce profitable returns – albeit much lower than might have resulted with good management.

So, we should attempt to measure management performance quite separately from return (profit) on resources used. This is perhaps best carried out subjectively, assisted by considering such things as market share, customer relations, employee turnover, etc.

(d) Return on investment

Measuring return on investment within a division is by no means straightforward. There is the problem of usage of central facilities such as warehouses, laboratories, and advertising. If each division is to be allocated some part of the central facility, the divisional manager no longer controls all the profit/investment content of the ratio measuring him. Maybe a divisional manager has control of his investment up to a certain level, beyond which he must seek further authority. Since presumably in times of scarce resources some requests for an extension of investment will be refused, the manager, again, does not control his investment.

It is generally accepted that, in conditions where investment is dictated to the division, control measurement should be based on maximising the absolute profit earned. This criterion implies that the central management will dictate policy as to the overall growth of each division. Maximisation of profit can be achieved quickly in the short term – for example, by slashing expenditure on maintenance, advertising, research and development, staff facilities and training, etc. – but these economies would leave the division in poor shape for future growth.

Using return on investment or, more accurately, maximisation of return on investment, is dubious. Percentages are averaging figures. A manager seeking to maximise return on investment, who already has a high return of, say, 20%, will reject projects which offer less than 20% because they will reduce his average return. However, a project offering, say, 18% would still be of great interest and benefit to the firm with a cost of capital of, say, 16%. By maximising the return of the division, it might also optimise the results of the company as a whole.

(e) Residual profit

Where the division has large, if not exclusive, control over its investment, the device of residual profit is important. Consider the following:

Firm/Division	**X**	**Y**
	£000	*£000*
Profit	300	900
Capital employed	1,500	6,000
Return on capital employed	20%	15%

Here X offers the best ***relative*** return on capital employed and appears to be the better performer. Of course, the levels of investment are disproportionate, as is often the case – i.e. we cannot say that Y is four times as big as X, etc., because in industrial activity some aspects

have to work side by side as necessary components of the whole, one may be capital-intensive as opposed to labour-intensive but both are vital.

If the cost of capital was 10%, then:

	X	**Y**
	£000	*£000*
Profit	300	900
less Cost of capital	150	600
Residual profit	150	300

Now Y offers the best ***absolute*** amount of money ***after*** meeting its capital cost.

Note that residual profit cannot be related directly to capital employed, as the relative volumes of capital have already been taken into account by charging their costs.

Generally, then, when the company/division has a large measure of control over its investment, the criterion of maximising ***residual profit*** is the best measure of performance.

The underlying criterion is, remember, the need to give central management a control measure on their divisions which lets each division behave in a manner which is optimal for the ***group as a whole*** and not just for the individual division.

(f) Currency issues

One of the major problems in overseas performance assessment is that the subsidiary may operate in a different currency and a decision has to be made as to which currency to use. When setting budgets, for instance, not only will there be assumptions concerning performance levels in terms of sales, etc. but also assumptions concerning exchange rates. In addition to this transaction exposure, if performance is looked at in home currency terms there may also be translation exposure to deal with.

Several methods have been suggested to try to overcome these problems; one solution involves preparing a most-likely budget in local currency and applying sensitivity analysis to produce a worst case scenario. Once exchange rates are definitely known (i.e. after the end of the period in question) this information can be used to calculate a set of standards for the year against which actual performance can be measured. Another method which has been suggested is to measure the net cash flows generated, convert them into home currency at the prevailing rate of exchange and discount them at the appropriate cost of capital to give a figure for net present value (NPV).

Any performance measurement scheme should have the following objectives:

- To evaluate the performance of individual managers.
- To monitor cash and profits generated to ensure they are adequate.
- To aid resource allocation.
- To provide a set of standards to motivate overseas subsidiaries.

Transfer Pricing

The underlying philosophy of the process of divisionalisation is that, by allowing divisions to trade and operate autonomously, divisional management is able to cultivate its profit motivation in a

competitive atmosphere. Of great importance is the situation where competing divisions supply not only the "outside" market but also the other divisions. Such inter-divisional trading can cause many problems.

Transfer pricing arises where member divisions of the same group carry on trade – transferring goods and services – with each other. Other financial transfers occur in the transfer of money from one country/currency to another within the group.

This is potentially a controversial area of multinational companies' activities because transfers may be made at a price which suits the needs of the group as a whole and ignores the needs of the subsidiary or the requirements of the host country.

- If divisions are to be judged by the criterion of profit and yet carry on trade with each other, profit or some representation of it must be built into the transfer price.
- If divisional behaviour is not to cause loss to the overall group, divisions may be ***directed*** by central management to provide or sell goods and services to their fellow group members.
- Alternatively, transfer prices may be determined centrally in order to ensure optimisation of the group's taxation policy. For example, group ABC (a multinational concern) finds that company A is facing high taxes on profits in a certain country. Company A can then be "forced" to transfer its goods and services to company B (also part of the group) at such a low price that company A makes little profit and company B makes a very large profit. The group as a whole gains by avoiding the taxes in the host country of company A.

The problem is that such direction may act against maximising individual divisions' performance, compared with what would have been achieved, say, by trading with outsiders.

(a) Determining transfer prices

Transfer pricing must be matched to its objectives. No divisional action must be allowed, by way of transfer price system inadequacies, to enhance the position of the division at the expense of the corporation. Secondly, it is important to promote divisional managerial motivation in the profit-orientated environment.

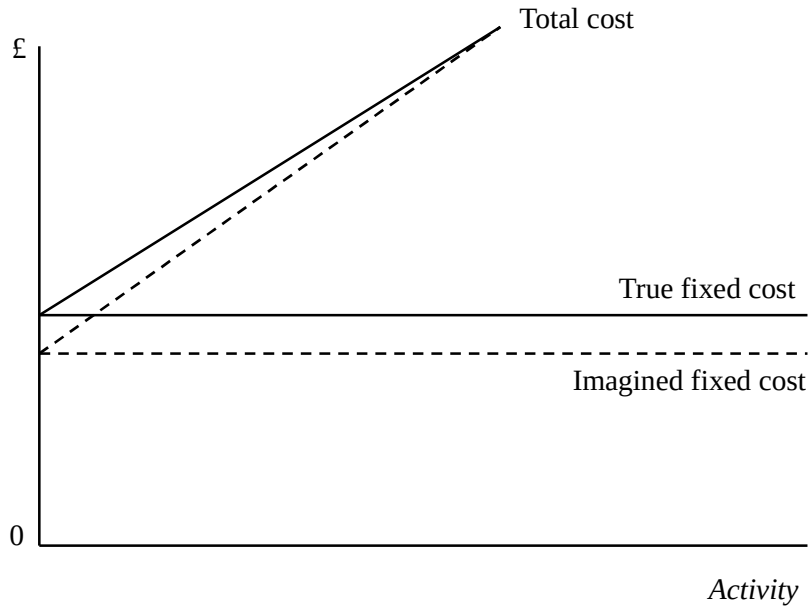
There are a number of methods of calculating transfer prices.

- ***Full cost***

  Where full cost is used there is an obvious danger. The user-divisions taking units of service or commodity from a supplying division at full cost (of the supply division) will regard this full cost as a ***variable*** cost to themselves. The more they use or buy, the greater the cost incurred by them. In fact, the cost they regard as variable will have a ***fixed*** as well as a ***variable*** content so far as the supply division is concerned.

  Now, the user-division will have its ***own*** fixed/variable cost pattern – although some of what they regard as variable cost is, in fact, partially fixed. The result is as shown in Figure 17.1, which represents a break-even chart for a user division with full cost transfer pricing from a supply division.

Figure 17.1: Break-even chart for a user division



The overall ***total cost*** will be the ***same*** but the ***fixed/variable patterns*** will be ***wrongly assumed***, due to regarding transfer prices as variables. The result could be some dangerously erroneous decisions where profit/volume factors become significant, with the margin of safety smaller than that assumed.

- ***Marginal cost***

  This clearly points to the use of a marginal cost basis which will, however, leave the problem of disposing of the supply division's ***fixed*** costs. This could be achieved either by charging them to the user-divisions in blocks (perhaps related to usage) or passing them to the central head office for charging to the consolidated accounts, the user-divisions receiving, in effect, a "two-part tariff" charge.

- ***Full or marginal cost plus profit***

  Full or marginal costs could have "profit" additions made to them to allow profit/investment measures to be unaffected by inter-group trading. The danger will be that user-divisions – possibly twice or more removed – will have a cost/selling price/discounts policy rather confused by the strata of internally-added profits.

- ***Current market price***

  Current market prices are the ideal solution to transfer pricing because they are objective and related to factual situations in the "outside world". Unfortunately, however, there will be few conditions where a one-to-one situation will exist between a division's product and one in the open market. External products will have minor design or quality differences, packing charges and discount structures, which make exact comparability impossible. Certainly, too, where the supply division's output is a half-processed unit, i.e. work in progress, or some intermediate process, such as polishing or packing, a comparable market price will not exist anyway.

- ***Negotiated price***

  The above situation may lead to the use of negotiated prices – but, then, might not individual managers spend more time and ingenuity squabbling over the negotiations than on advancing the overall corporate effort, perhaps leading to central dictation again?

Which method to adopt will depend on prevailing circumstances in the company, namely:

- The central control or freedom of action imposed upon or allowed to divisions by the corporate management.
- The existence of comparable markets for the products of the divisions at the intermediate stages of production.
- The extent to which divisions are free to buy from, and sell to, the outside market, rather than being restricted to using fellow divisions as suppliers or outlets.

All methods of transfer pricing are beset with practical difficulties related to circumstances in the firm. Perhaps the most favourable technique is to have some "two-part tariff" arrangement, where each division's fixed costs are charged to user-divisions regardless of their use of them. The variable costs – possibly with a profit addition – are charged on the basis of consumption by the users.

This suggestion, of course, tends to assume that usage is a sequential pattern with A passing to B, and B to C, etc. Often, in practice, a reciprocal position may arise, where subsidiary's costs are interdependent.

Also, are the fixed costs to be amalgamated with B's and passed on? In view of the optimising/allocation nature of the problem, a mathematical programming approach may produce the best answer.

(b) Reasons for manipulating transfer prices

One of the most common reasons for the manipulation of transfer pricing is known as "tax planning", which involves the careful and systematic avoidance of taxes to make sure that profits are not taxed twice – i.e. by two governments. Another reason is the fear that, if too large a profit appears against a particular subsidiary, pressure will be applied by government or customs to reduce prices, or by trade unions seeking large wage increases.

Another influence on transfer prices is the market conditions in which a subsidiary operates. The "family" network of a large worldwide group may make possible a price war to gain a market advantage.

Governments are always finding ways to cancel out any tax advantages a company may discover. They can make a careful check on comparative import and export prices, and will soon discover if transfer pricing is being allowed to distort the position. For example, in the UK the Controlled Foreign Company legislation was introduced to prevent transfer prices being manipulated and tax havens used for undue tax avoidance.

(c) Large transfers of funds

One of the most controversial aspect of the MNC is its ability to move enormous sums of money between subsidiaries in different countries.

The reasons for large transfers of funds around the world include:

- Funds for new investment
- Payments of profit and interest

- Making and repayment of loans between member companies
- Payments for goods, services and expenses

The main fear of international companies is that money will be lost due to factors beyond their control, such as restrictions on the return of profits from a subsidiary to a parent company, and the effects of changes in the value of currencies. This is why one of the trends in international business is to pay the parent company as large a profit return as possible, even if loans have to be made in order to keep the subsidiary in liquid funds.

If international trade were entirely a matter of arm's length transactions – i.e. between separate and unconnected companies in different countries – the movement of funds would be easier for governments to follow and control.

(When a subsidiary in another country is not fully-owned problems are likely to arise as group objectives pull one way and those of the subsidiary the other. For this reason MNCs much prefer to make their subsidiaries wholly-owned.)

D. INTERNATIONAL INVESTMENT DECISIONS

The criteria by which investment opportunities are selected will vary between companies. MNCs often prefer to invest in their own domestic market, and will only go abroad if they can secure a higher rate on capital by so doing. However, sometimes the MNC will undertake a foreign investment that is uneconomic. The main reasons for this are:

- To ensure an outlet for some other aspect of its worldwide operations – for example, an oil company may construct a refinery as an outlet for its own crude oil production.
- To safeguard its existing interest – for example, by producing a new but uneconomic car, in order to keep a brand name alive for the sake of a larger, successful model.

Studies indicate that many MNCs do not have a master plan for international investment but review each individual project on its merits. It is generally the viability of the project, rather than the finance available for investment, that is the key to the investment decision.

Factors Affecting the Investment Decision

The decision to locate, or relocate, part of an MNC's operations in a foreign country will follow detailed research and often complex negotiations. Of the issues which will primarily concern the management team, the following will be of particular significance:

(a) Will the investment be temporary or permanent? For example, a temporary investment, such as a mine, will be worked out within a finite period of time. In such cases a loan will generally be the best method of financing, whereas for permanent investment equity will usually be the best approach.

(b) Is it best to operate as a branch or should a separate local company be created? The answer to this question will depend on local considerations, including the tax laws of the country concerned, as well as strategic policy regarding decentralisation of control of subsidiaries. It may be advantageous to have a branch overseas if unprofitable, converting it to a subsidiary when it becomes profitable. Special EU rules (for example on mergers) can create other problems or advantages when deciding on the structure of overseas operations.

(c) Where borrowing is envisaged, should funds be borrowed locally, provided through the parent or raised through the euromarkets, and what exchange risk will be involved? What is the cheapest and safest way of providing capital?

(d) The political, economic and currency environment, and particularly their stability, of the country will determine a number of important factors, including

- The stability of the market for raw materials.
- Controls on the movement of product and currencies, and particularly how difficult the repatriation of funds may be in the future.
- Inflation and local taxes.
- Whether it would be politically wise to have a local participation in the chosen country.
- The support, assistance (and interference) of, and by, the government of the country.

(e) Other aspects of the business environment such as communication facilities, the ability to acquire an established firm or whether a "green field" operation can be developed, the availability and cost of suitably qualified labour and management, and the industrial relations record of the country, and the level of competition already established in the region.

Entities trading internationally face particular difficulties based around different currency units which can cause potential problems in translating one unit of currency into another. They also have the problem of different laws, taxes, business practices and cultures which may be incompatible with existing operating methods.

International Investment Appraisal

The assessment of the viability of overseas projects has many features in common with the assessment of domestic projects. There are, of course, also marked differences so that domestic budgeting techniques form only the foundation of overseas capital budgeting.

Investment appraisal in an MNC is conducted in a similar manner to the assessment of domestic projects – using such techniques as net present value (NPV) and internal rate of return (IRR). However, there may be differences adopted to reflect the differing nature of the investment:

(a) Cost of capital

The first issue is determining the cost of capital to be applied – for example, by using the capital asset pricing model or the dividend growth model. However, if the risk/return pattern of the project is in any way different to that of the company as a whole then due allowance should be made by calculating a project-specific return.

Because the project is overseas based it is possible that the elements used to finance it will be a mixture from the two countries concerned. If overseas funds are utilised then further adjustments may be necessary due to the following:

- ***Retained earnings*** of the subsidiary or project which may be subject to withholding taxes or tax deferral (which we shall look at shortly).
- ***Local currency debt*** – this is the after-tax cost of borrowing locally in the country concerned:

(b) Discount rate applied

An increase in currency and political risk may lead to the firm increasing the discount rate used to evaluate projects; or the firm may use the discount rate determined by its overall systematic

risk level (if it is assumed to be unchanged by the potential investment) and adjust the cash flows for the expected political and currency risk. In practice the discount rate is adjusted for political risk – because all cash flows would be affected by adverse political circumstances, whereas currency risk may have some beneficial, and some detrimental, effects on cash flows and as such is accounted for by adjusting cash flows.

(c) Parent or project cash flows

The project must be shown to be beneficial both in the host country and its currency, and in terms of funds remitted to its parent, in order to fully justify it, both from the point of view of the parent company and in comparison with other (potential) projects in the host country.

However, the cash flows that are generated by the project are not necessarily those that will be received by the parent. There may, for instance, be exchange control regulations limiting the transmission of funds, in which case some of the methods outlined earlier under the unblocking of funds may be used. It is important that the distinction between the two is understood as decisions made on the strength of project cash flows can be very misleading.

The factors affecting cash flows which must be allowed for in investment appraisal include the following.

- Exchange rates – the added complication that cash flows have to be converted from the host currency to the domestic one.
- Different tax rates in home and host country – which we shall look in more detail at taxation shortly, but you should be aware that overseas taxation can play a major part in determining whether or not a project is viable.
- Royalties and fees payable out of the income – which cause differences between cash flows to the project and to the parent company.
- Restrictions imposed on the flow of funds from subsidiary to parent – which may alter the complexion of the project from the parent's point of view.
- The different rates of inflation between the host country and that of the parent.

Repatriation of Profits

The aim of investment in overseas subsidiaries is to increase group profits for the MNC and central to this is the ability to transfer value through the group.

Those companies with inter-divisional trade need to determine the level at which to set transfer prices for goods and services provided by one group member for another. The basis on which the transfer price is set will affect the profit share of the group, and should be determined in order to maximise group profits by developing the motivation of subsidiaries and circumventing any repatriation controls imposed by the host government.

Transfer prices of goods and services provided by group members for each other are one way of obtaining cash returns from an overseas subsidiary. Others include:

- Royalties charged to the subsidiary for making goods, or providing services, for which the parent holds the patent.
- Management charges levied in respect of services provided by head office.
- The subsidiary may borrow from its parent, and thus pay interest charges to it.
- Dividends which can be paid to the parent on the equity provided by it.

The choice of method of obtaining cash returns, and level received from each (often by manipulating the various factors – such as the rate of interest for parental loans), will be determined by the requirements of the parent and the subsidiary, any exchange controls present and the perceived risk of the investment.

This manipulation can make the interpretation and evaluation of the accounts of MNCs and their subsidiaries extremely difficult. The problem is exaggerated by the differing accounting policies used in different countries; the differing choices made as to which exchange rates (actual (and at what date) or predicted) to be used in setting forecasts and translating accounts into the parent company's currency; and the different economic and political circumstances a subsidiary may be operating in.

Overseas Taxation

The impact of overseas taxation can play an important part in the investment decision, as noted above.

Withholding taxes, for instance, will be met quite regularly. These are taxes collected from foreign corporations or individuals on income earned in that country. A UK resident in France, for instance, may find that any dividends he receives could be subject to a withholding tax of 20% which is then paid over to the French revenue authorities. Credit is usually given in the home country for any taxes paid abroad. Thus, if a UK resident was in the 40% tax bracket and had suffered the 20% withholding tax above, he would be liable for 20% of UK tax on that particular income. It is often the case, however, that if the withholding tax rate exceeds the home country tax rate then no credit is given for the excess tax paid abroad.

Thus, double taxation relief is available in income earned abroad. An important strategic consideration that must be taken into account when setting up an operation overseas is whether to operate it as a branch or subsidiary. If the former, then UK tax is paid on income which is repatriated, and there may be cash flow advantages in manipulating dividends to be taxed in a different accounting period.

If income from abroad is not repatriated then it will be subject only to foreign tax and not to withholding tax or UK tax.

If the profits of an overseas operation were transferred to a tax haven they would not be subject to UK tax but the withholding tax would be deducted. A tax haven is a country where tax on resident companies, foreign investment and withholding tax paid on dividends paid overseas are low. For these reasons they are often used by MNCs as a means of deferring tax prior to the repatriation of funds. For this to be successful, the tax haven requires adequate financial services, a stable exchange rate and a stable government.

UK companies may also consider transferring residence in order to avoid paying UK corporation tax (this is subject to various Inland Revenue rules).

Study Unit 18

Risk and the International Business

Contents ***Page***

INTRODUCTION

All businesses face a degree of risk. One facet of this risk is "business risk" – that arising from the very nature of the business itself. We can divide this type of risk into two groups.

- That which is inherent in the ***conduct of business*** itself and cannot be reduced or eliminated without ceasing trading – effectively closing down the business or selling it. (The owner(s) accept this type of risk in making their investment and expect some form of financial return as compensation.)
- That which arises as a consequence of the ***financial transactions*** taking place in the normal course of business. Essentially, we are concerned here, in the international context, with the possibility of incurring a loss of value on certain types of transaction – those which involve making/receiving payments in a different currency – as a result of changes in the exchange rate. It is this element of risk exposure which the business can seek to reduce or eliminate.

In the international arena, there is a further type of risk – ***political risk***. This relates to the possibility that the conditions under which a business entered a foreign market may change and adversely affect the financial position of the business. This can arise from the decisions of governments to change, for example, taxation levels or other aspects of the economic environment of the country.

It is not possible to eliminate these risks completely, but it is possible to reduce them by adopting appropriate strategies to reduce the amount of exposure to loss that the business is faced with.

In this unit, we start by examining in some detail the nature of these risks, and then consider the ways of managing political risk. We then move on to consider techniques to manage exchange rate exposure in two categories:

- ***internal***, or natural, techniques – those which are effected entirely by the financial organisation and structure of the company itself; and
- ***external***, or transactional, techniques – those using the range of derivative instruments which are effected by the use of third party services, such as banks and specialist exchanges.

Although both types of technique provide effective means of covering the exposure, certain external techniques offer the possibility of taking advantage of favourable movements in exchange rates to generate profits.

A. RISK AND INTERNATIONAL TRADE/FINANCE

In addition to normal business and financial risk, companies face extra risks connected with trading and investing overseas. These risks can be separated into ***political risk*** and ***foreign exchange risk***.

Political Risk

Political risk (also known as country risk) includes the problems of managing subsidiaries geographically separated and based in areas with different cultures and traditions, and political or economic measures taken by the host government affecting the activities of the subsidiary.

Whilst a host country will wish to encourage the growth of industry and commerce within its borders, and offer incentives to attract overseas investment (such as grants), it may also be suspicious of outside investment and the possibility of exploitation of itself and its population. The host government may restrict the foreign companies' activities to prevent exploitation or for other political and financial reasons. Such restrictions may range from import quotas and tariffs limiting the amount

of goods the firm can either physically or financially viably import, to appropriation of the company's assets with or without paying compensation. Other measures include restrictions on the purchasing of companies, especially in sensitive areas such as defence and the utilities – such restrictions could be an outright ban, an insistence on joint ventures or a required minimum level of local shareholders. In order to prevent the "dumping" of goods banned elsewhere (e.g. for safety reasons) a host government may legislate as to minimum levels of quality and safety required for all goods produced or imported by foreign companies.

Host governments, particularly in developing and underdeveloped countries, may be concerned about maintaining foreign currency reserves and preventing a devaluation of their national currency. In order to do this they may impose exchange controls. This is generally done by restricting the supply of foreign currencies – thus limiting the levels of imports and preventing the repatriation of profits by MNCs by restricting payments abroad to certain transactions. This latter method often causes MNCs to have funds tied up unproductively in overseas countries.

Foreign Exchange or Currency Risk

Exchange rate risk applies in any situation where companies are involved in international trade. It arises from the potential for exchange rates to move adversely and, thereby, to affect the value of transactions or assets denominated in a foreign currency.

There are three main types of exchange rate risk to which those dealing overseas (importers, exporters, those with overseas subsidiaries or parents, and those investing in overseas markets) may be exposed.

(a) Transaction exposure

This occurs when trade is denominated in foreign currency terms and there is a time delay between contracting to make the transaction and its monetary settlement. The risk is that movements in the exchange rate, during the intervening period, will increase the amount paid for the goods/services purchased or decrease the value received for goods/services supplied.

(b) Translation exposure

This arises where balance sheet assets and liabilities are denominated in different currencies. The risk is that adverse changes in exchange rates will affect their value on conversion into the base currency.

Any gains or losses in the book values of monetary assets and liabilities during the process of consolidation are recorded in the profit and loss account. Since only book values are affected and these do not represent actual cashflows, there is a tendency to disregard the importance of translation exposure. This is, though, a false assumption since losses occurring through translation will be reflected in the value of the firm, affecting the share price and hence, shareholders' wealth and perceptions among investors of the firm's financial health.

(c) Economic exposure

This refers to changes in the present value of a company's future operating cashflows, discounted at the appropriate discount rate, as a result of exchange rate movements.

To some extent, this is the same as transaction exposure, and the latter can be seen as a sub-set of economic exposure (which is its long term counterpart). However, economic exposure has more wide ranging effects. For example, it applies to the repatriation of funds from a wholly-owned foreign subsidiary where the local currency falls in value in relation to the domestic currency of the holding company. It can also affect the international competitiveness of a firm – for example, a UK company purchasing commodities from Germany and reselling them in

China would be affected by either a depreciation (loss of purchasing power) of sterling against the Deutschmark and/or an appreciation of yuan.

It can also affect companies who are not involved in international trade at all. Changes in exchange rates can impact on the relative competitiveness of companies trading in the domestic market vis-à-vis overseas companies when imports become cheaper. Thus, reduced operating cashflows may be a consequence of a strengthening domestic currency – a situation which has affected UK companies in the late 1990s.

The management of exchange rate risk will involve hedging against adverse movements in order to contain the extent of any exposure. At the operating level, the focus of attention is primarily on managing the exposure caused by transaction and economic risk, both essentially being underpinned by cashflows. The techniques which we shall examine in this unit, then, relate essentially to these aspects of exposure, with the greater emphasis on transaction exposure

B. MANAGING POLITICAL RISK

Political risk relates to any action that can be taken by an overseas government which can affect a firm's investment in that country. There are many different ways in which it can manifest itself, for example:

- Changes in tax laws.
- Changes in the rules concerning transfer of funds.
- Stipulations concerning the amount of local production or employment.
- Changes in exchange controls.
- Expropriation of assets – i.e. government seizure.

Dealing with Political Risk

Firstly, it is important that any firm considering direct overseas investment is aware of the potential political risks involved and there are two main methods of approaching this assessment:

- **The macro approach** – This is country-specific and can be achieved by using one of the many political risk forecasting services which are available. The usual format of these services is that each country is ranked on a series of different factors to give an overall rating. These factors take into account items such as political stability (or instability as the case may be), fractionalisation of the country by language or religious groups and so on. Depending on its rating a country may be considered a minimal risk through to a prohibitive risk.
- **The micro approach** – This is firm-specific and is based on the fact that it is the type of industry that determines the level of risk rather than the country in which it operates. Thus, extractive industries are considered to be more at risk than firms in the service sector.

The methods of dealing with the risk are to:

- Identify those areas where the risk is considered unacceptable and refrain from making the investment.
- Insure against the risk – for example, in the UK, through Lloyds of London, which is the only organisation to provide cover against expropriation of new or existing assets to a limit of 90% of equity participation.

- Negotiate with the overseas government before making the investment – as a means of reaching agreement on the rights and duties of each partner – although any agreement can be negated by a change of government.
- Structure the overseas operation to make expropriation by the host government a waste of time – for example, by making the foreign company dependent on the group for supplies of spare parts or raw materials.

Operating policies can also be employed to minimise political risk. They can take several forms including short-term profit maximisation, planned divestment and the encouragement of local shareholdings.

Where expropriation is threatened or has taken place, the following are some of the courses of action which could be taken:

- Negotiate with the government concerned and attempt to halt or reverse the decision.
- Bargaining – whereby the MNC offers something in return for the host government desisting from expropriating the asset, such as agreeing to use more locally-produced parts in manufacture, hiring more local managers, investing more capital or surrendering majority control.
- Agree to relinquish control in return for compensation – i.e. effectively sell the assets and pull out.
- Political lobbying – This could take the form of lobbying the home government to intervene on behalf of the MNC or alternatively pursuing an action through the international courts. In addition, it may be worth lobbying to attempt to block certain imports from the country concerned, although this has wider trade implications and is less likely to be successful.

Restrictions on the Remittance of Funds

An MNC is in a position whereby it can transfer funds from one location to another as part of its regular operating cycle to keep overseas subsidiaries adequately financed and to remit surplus funds to the home country. This also allows the MNC to take advantage of arbitrage opportunities that may exist in terms of:

- Reducing the overall tax burden by shifting profits from high to low tax areas or from paying to participating subsidiaries.
- Circumventing credit control restrictions in the country of operations by remitting funds to subsidiaries located there.
- Taking advantage of high interest rates to invest surplus funds or low interest rates to borrow funds.

Unfortunately for the MNC, most countries impose restrictions on the transfer of funds into and out of their country, usually in order to be able to maintain their currency value within defined limits.

In order to overcome such restrictions the MNC can adopt one or several of the following options:

(a) Transfer pricing

We have already examined the importance of transfer pricing to an MNC. Remember that it is perhaps the most widely used method of transferring funds and one which host countries assume is used to their detriment and therefore should be tightly controlled.

Transfer pricing is especially relevant to those businesses dealing internationally due to the increased complexity of the possible sourcing decisions. Much of this complexity arises from

the sheer number of transfers, exchange rate movements and the amount of information on international sales and costs required. Obviously a good financial decision support system (DSS) is required for such companies, although the cost may be prohibitive – one possible solution is to break the organisation down into smaller units and thereby simplify the amount of information involved..

A further element of complexity for both production location decisions and for transfer pricing is the need for companies to consider the impact of taxation – the aim will be to set transfer prices which minimise the level of tax paid whilst ensuring that laws are not breached. For taxation purposes, MNCs often use cost-plus based transfer pricing systems, with a separate system being used for performance management. This, however, may not be allowed in certain countries. UK-resident companies are liable to corporation tax on profits before foreign taxes of overseas investments (though double taxation relief is generally available). Thus, where the effective tax rate is lower overseas than in the UK and there are no exchange rate or cash flow requirements to repatriate profits, there are benefits in leaving the cash (and profits) overseas. However, companies must be careful not to fall foul of anti-avoidance legislation.

A large MNC needs to determine its location and transfer pricing systems to ensure that the best economic outcome from the perspective of the group is achieved. In doing so, it must consider a large number of factors – for example, relative productivity, inflation, exchange rate volatility and management, interest rates, transportation costs, proximity to markets and price elasticity, as well as the costs of reversing such decisions. The decision may be made by comparing the total contribution to the group (often referred to as ***total system profit*** or ***decision profit***) of the different alternatives. However, in order to do this a transfer pricing system must have been developed, thus creating a somewhat circular problem.

A further method that may be used is arm's-length transfer pricing. However, this reduces HQ's involvement and as such it may not be in the group's interest.

(b) Leading and lagging

We consider this in more detail below in respect of managing exchange rate risk.

In the context of unblocking funds, suppose that company A in one country sells goods to an affiliate in another country of £1m per month, with payment terms one month after receipt. If the payment terms are then altered to three months an additional £2m will be "lagged". If payment terms are shortened the funds will be transferred more quickly. Note that each of these will be a one-off movement.

(c) Dividends

This is another important method of moving funds between countries. The level of dividend set will depend on considerations such as the levels of taxation, the existence of exchange controls which may restrict the transfer of funds, the expected changes in exchange rates which may cause a firm to accelerate or delay payments, and the effect on the financial statements of affiliates.

(d) Loans

These can take the form of:

- ***Parallel loans*** – which involve no cross-border movement of funds and usually allow for the loans to be set off against each other.
- ***Back-to-back loans*** – which are often used to finance associates in countries with high interest rates or where different rates of withholding tax apply.

(e) Currency swaps

These are made between two parties who agree to transfer currency at the prevailing spot rate with an undertaking to reverse the transaction at a future date. No interest is payable but a fee is usually paid by one party to reflect the forward premium or discount on the currency transferred.

Again, we examine these in more detail below when considering exchange rate risk.

(f) Fees and royalty agreements

These usually take the form of management fees from the subsidiary to the head office based on the amount the latter wishes to receive in total, which is then apportioned out to the subsidiaries based on, for instance, the sales of each. Overseas governments prefer agreements to be in place in advance and for there to be a steady flow of funds rather than an erratic one, which could indicate an obvious attempt to manipulate the flow of funds.

(g) Debt versus equity

Consideration should be given to the best way of financing an overseas subsidiary depending on the ease of moving different types of funds. In this instance it is the ease of repatriating interest and repayment of capital compared to dividends or reductions in equity. Loans are often preferable as reductions in equity may be difficult, or even impossible, to achieve and loan interest is usually tax deductible. Account will also have to be taken of local government requirements for financing through the issue of equity.

(h) Re-invoicing centres

These are often sited in low tax countries and take title to all goods sold across frontiers either between subsidiaries or to a third party. The goods themselves pass as usual from seller to buyer with payment being made to the re-invoicing centre. The great advantage with this arrangement is the possibility of utilising currency-invoicing techniques, which we consider next.

(i) Currency of invoice

The objective of this technique is to invoice in a strengthening or weakening currency in order to transfer funds from one country to another. Thus, if a currency is expected to weaken, by invoicing in that currency the company will receive less for its goods when paid for by an affiliate in another country, but of course the affiliate will gain by effectively paying less for the goods in question. As an example, suppose affiliate A is transferring goods to affiliate B in a currency which is expected to devalue by 5%. If the goods are worth £10 million this will effectively mean a transfer of £500,000 to affiliate B. It is possible to invoice in any currency depending on the circumstances – so if a country imposes restrictions on capital inflows, it is possible to invoice in a weak currency in order to transfer funds there.

Again, this is also used as a means of managing exchange rate exposure and will be considered later in the unit.

(j) Other techniques

It is also possible to utilise blocked funds in other ways to those mentioned above. One method is to purchase items, such as machinery, with the blocked funds in the country concerned, but utilise the items worldwide throughout the group. Other alternatives are to purchase services or carry out R & D in that country, the benefit of which will again be enjoyed by the group as a whole.

C. INTERNAL METHODS OF MANAGING EXCHANGE RATE RISK AND EXPOSURE

There are four main internal means of reducing exchange rate exposure. These are based on methods of processing transactions and payments, and of offsetting assets and liabilities in different currencies.

Currency invoicing

The first approach is simply to invoice foreign customers in the currency of the seller.

Invoicing for goods supplied, and paying for goods received, in a company's domestic currency removes the exchange rate risk for that company – but only one party to an exchange between foreign companies can have this facility, and the other bears the risk of exchange rate fluctuations. However, the advantages of removing exchange rate risk need to be weighed against those of invoicing in the foreign currency. These include marketing advantages such as the ease for the customer of dealing in his own currency and the possibility of purchasing at a discount if the foreign currency is depreciating relative to the domestic currency. In fact, often the only way to win a contract overseas is to deal in the currency of that market.

One way to prevent one or both parties being subject to exchange rate risk is for the firms involved to set a level of exchange rate to use for a transaction regardless of what the actual exchange rate is on the day the money is transferred.

Netting

This is an internal settlement system used by multinational companies with overseas subsidiaries. It involves offsetting (netting out) the outstanding foreign exchange positions of subsidiaries against each other through a central point – the group treasury.

Suppose there are two overseas subsidiaries in different countries. Subsidiary A expects to receive a payment in one month's time for the sale of goods to the value of $2m, while subsidiary B has to make a payment of $3m in one month's time to a supplier. The central treasury can offset the two exposures and set up an external hedge for the net risk of $1m. This negates the need for two separate hedges to be carried out – the first to cover the $3m against a rise in exchange rates against the dollar and second to cover the $2m against a fall in exchange rates against the dollar. The single hedge is more efficient and cost-effective.

Matching

This is the process of matching receipts in a particular currency with payments in the same currency. This prevents the need to buy or sell the foreign currency and thus reduces exchange rate risk to the surplus or deficit the firm has of the foreign currency. It is a cheap method of reducing or eliminating exchange rate risk provided that the receipts precede the payments, and the time difference between the two is not too long.

For example, where a company is selling to the US and has outstanding receipts denominated in $, it could purchase raw materials in the same currency. The one transaction will offset the other and minimise the exchange exposure that requires external hedging. It therefore does not matter whether the $ strengthens or weakens against the domestic currency.

Alternatively, a firm could match, say, dollar currency receipts from the export of goods to the US with a dollar loan. The receipts will be used to pay off the loan. This again secures the matching of an asset with a liability.

This process can be made easier either by having a bank account in the foreign country or a foreign currency account in a firm's own country, and putting in all receipts and taking from it all payments in the overseas currency. The exchange rate risk on the surplus or deficit can be avoided by utilising one of the other methods of risk management.

Matching may also be used to reduce translation exposure – offsetting an investment in assets in one currency with a corresponding liability in the same currency. For example, the acquisition of an asset denominated in Yen could be achieved by borrowing funds in Yen. As the exchange rate against the Yen varies, the effect it has on the translated value of the asset and liability will increase and decrease in concert. The amount of the reduction in exposure will depend on the extent to which the expected economic life of the asset corresponds with when the loan matures.

Leads and Lags

This final method of hedging internally involves varying payment dates to take advantage of the exchange rate – for example, paying either before or after the due date, depending on exchange rate movements. The effectiveness of this is dependent on how well exchange rate movements can be anticipated. A company will only pay in advance if it expects the domestic currency to weaken, but if it misreads the movement and the exchange rate strengthens, advance payment may prove expensive.

- ***Leads*** are advance payments for imports to avoid the risk of having to pay more local currency if the supplier's currency increases in value.
- ***Lags*** involve slowing down the exchange of foreign receipts by exporters who anticipate a rise in the value of the foreign currency received. When this occurs, they will then benefit by an exchange rate in their favour.

The table below shows the scope for leading and lagging by financial managers of importers or exporters:

Expectation of foreign currency	**UK Exporter** *Receiving foreign currency*	**UK Importer** *Paying foreign currency*
Devaluation	Leads	Lags
Revaluation	Lags	Leads
Expectation of sterling	**Foreign Importer** *Paying in sterling*	**Foreign Exporter** *Receiving sterling*
Revaluation	Leads	Lags
Devaluation	Lags	Leads

A UK exporter would ***accelerate*** (lead) his receipts in the event of an anticipated ***devaluation***, but he would ***delay*** (lag) his foreign receipts if a ***revaluation*** was expected, and so forth. In leading, he will need to borrow or otherwise raise the cash which will involve a cost of capital, whilst lagging will attract interest as there will be surplus for investment.

D. EXTERNAL METHODS OF MANAGING EXCHANGE RATE RISK AND EXPOSURE

It is not possible to eliminate exchange rate risk completely, but it is possible to reduce it by way of ***hedging***. Hedging the risk involves taking action now to reduce the possibility of a future loss, usually at the cost of foregoing any possibility of a gain. A simple example in relation to commodity trading should explain this.

A firm knows that it will need certain goods in six months' time. It is exposed to the risk that the price of these goods may rise in the meantime. This risk may be reduced by entering into a "forward contract" to purchase the goods in six months' time at a price fixed now. However, if the price falls below the current price in the meantime, the firm will have lost the opportunity to make a gain.

Thus, the basis of hedging involves offsetting two transactions against each other:

- a cash transaction – the receipt or payment of money arising from normal business transactions (such as international trade or the management of funds); and
- taking a position on (buying or selling) a ***derivative instrument*** linked to the type of cash transaction.

There are a number of such financial derivatives relating to currency – forwards and futures contracts, swaps and options. Options are somewhat different in that they offer the possibility of making gains as well as hedging risk.

Principles of Hedging

As we noted above, hedging a risk involves taking action now to reduce the possibility of a future loss, usually at the cost of foregoing any possibility of a gain. It is a process whereby the exposure to potential loss caused by adverse movements in prices, interest rates and exchange rates may be limited.

A hedge against exposure to risk is invariably constructed by using a financial derivative. Again, as we noted above, there are a range of these instruments. They "derive" their value from the price of underlying assets such as foreign currencies, commodities and fixed income securities, etc. We can demonstrate the basic concept with an example using one such instrument – a futures contract – in relation to exchange rate exposure.

A UK firm is going to receive a $100,000 in one month's time as a result of some consultancy work carried out in the USA. It is exposed to the risk that an (unfavourable) movement in the £/$ exchange rate before the payment is made will reduce its value. However, it may hedge this risk by using a futures contract. The futures contract will comprise a transaction to sell $100,000 in one month's time (the time of its receipt) at a £/$ exchange rate fixed today. The potential loss of value on the payment is, then, limited to the difference between the current exchange rate and the agreed rate for the futures contract. This reduces the company's exposure to any other adverse movements in the exchange rate, but also means that it cannot take advantage of a favourable movement in the rate.

Futures are one of the derivatives that allow a financial risk to be reduced, but do not (usually) allow any gain to come from favourable movements in the prices or rates underlying the instrument. Other such derivatives include forward contracts and swaps. However, these can be distinguished from option contracts which also allow a risk to be reduced, but ***do*** allow gains to be made from favourable movements.

Forward Contracts

Forward foreign exchange contracts are a binding agreement between two parties to exchange an agreed amount of currency on a future date at an agreed fixed exchange rate. The exchange rate is fixed at the date the contract is entered into.

Forward contracts are tailor made to suit the needs of the parties and delivery dates can range from a few days to upwards of several years, depending on the needs of the business. They are binding and must be executed by both parties.

In most cases, forward contracts have a fixed settlement date. This is appropriate where the cash transaction being hedged will take place on the same day that the forward contract is settled. However, there is no guarantee that the two days will tally – for example, a customer may be late paying – in which case the fixed settlement date is less than optimal. An alternative, to provide flexibility, is an "***option date forward contract***". This offers a choice of dates on which the user can exercise the contract, although there is a higher premium payable on the contract for such an additional benefit.

The purpose of a forward exchange rate contract is to purchase currency at a future date at a price fixed today. As such, it provides a complete hedge against adverse exchange rate movements in the intervening period.

Consider the following example. (You do not need to worry about the detail of how the hedge works, but showing the method illustrates the principles.)

A UK company needs to pay A$1m to a Australian company in three months' time. The current spot and forward exchange rates for sterling are as follows:

	A$/£
Spot	2.730 – 2.735
3 months forward	4 – 3 cents pm

What would be the cost in sterling to the UK company if it enters into a forward contract to purchase the A$1m needed?

Note the way in which the rates are quoted. The spot rate (the current price) spread shows the sell and buy prices – the banks will sell A$s for sterling at the rate of A$2.730/£, and buy A$s in return for sterling at the rate of A$2.735/£. The forward rate is quoted in terms of the premium ("pm") in cents which the Australian dollar is to sterling in the future. If the currency is at a premium, it is strengthening and the A$ will buy more pounds forward than it will spot or, conversely, the pound will buy less A$ forward than it will spot. (If the quoted forward rate had been quoted at a discount – say, "3 cents dis" – this would indicate a weakening of the currency.)

To calculate the cost of the forward contract, we need to convert the forward rate premium into an exchange rate. Because it is a premium, we need to subtract the amount from the spot to give the following sell/buy forward rates:

$$(2.730 - 0.04) - (2.735 - 0.03) = 2.690 - 2.705 \text{ A\$/£}$$

The cost of buying A$1m forward, therefore, is:

$$\frac{\text{A\$1,000,000}}{2.690} = \text{£371,747}$$

Currency swaps

In general, a swap relates to an exchange of cashflows between two parties. Thus, currency swaps relate to an exchange of cashflows in different currencies between two parties. They are agreements to exchange both a principal sum and the interest payments on it in different currencies for a stated period. Each party transfers the principal and then pays interest to the other on the principal received.

Swaps are arranged, through banks, to suit the needs of the parties involved.

The two key issues in setting up a currency swap are:

- the exchange rate to be used; and
- whether the exchange of principal is to take place at both commencement and maturity, or only on maturity.

The following example illustrates the general principles. (Again, you should not be too concerned with the detail, but just follow the principles.)

A German company is seeking to invest £20m in the UK and has been quoted an interest rate of 8% on sterling in London, whereas the equivalent loan in Deutschmarks is quoted at 7% fixed interest in Frankfurt. At the same time, a UK company wants to invest an equivalent amount in its German subsidiary and has been quoted an interest rate of 7.5% to raise a loan denominated in Deutschmarks on the Frankfurt Exchange. It could, however, raise the £20m in sterling in London at 5% fixed interest.

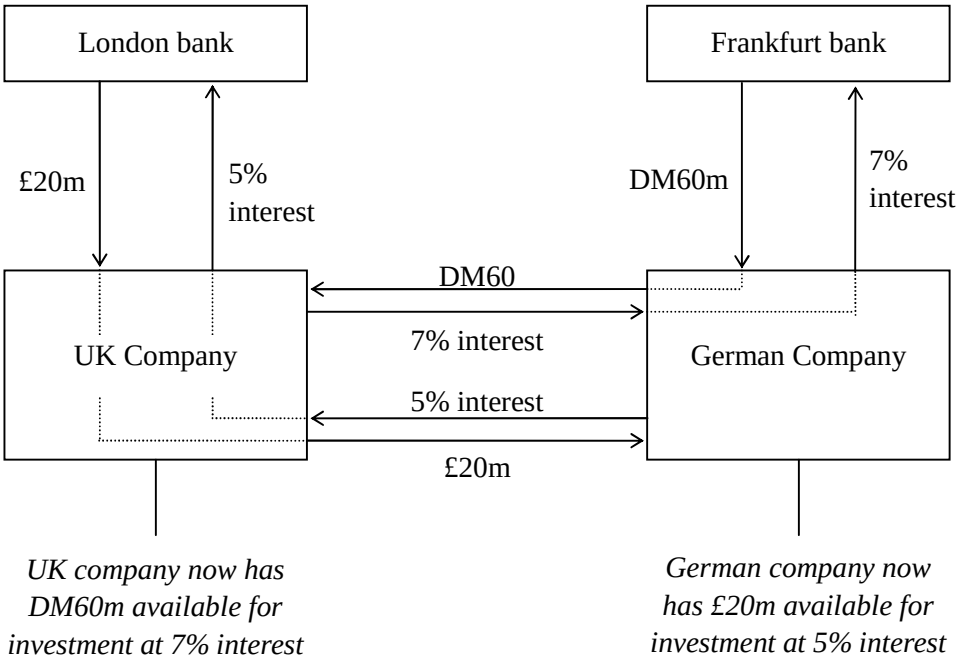
In the absence of a swap, each company would have to accept the quoted terms for its loan denominated in the foreign currency. This would result in both companies paying a higher rate than would apply if the loan was raised in their domestic currency. A swap agreement would involve each company taking out the loan in its own domestic currency and then exchanging the principals. Each company would pay the interest on the principal received – i.e. the other company's loan – and at the end of the loan period, the principals would be swapped back.

The exchange rate to be applied is clearly crucial. If we assume that this is agreed as DM3 = £1, the swap would be conducted as follows.

- The UK company borrows £20m in England at an interest rate of 5% pa. It then swaps the principal of £20m for DM60m (at the agreed exchange rate) with the German company. The German company pays the interest payments on the £20m loan (at 5% interest) to the UK company, which then pays the bank. At the end of the loan period, the principal of DM60m is swapped back for the £20m with the German company.
- The German company borrows DM60m in Frankfurt at an interest rate of 7% pa. It then swaps this principal with the UK company which pays the interest payments on the loan (at 7% interest) to the German company, which then pays its bank. At the end of the loan period, the principal of £20m is swapped back for the DM60m with the UK company.

The process is illustrated in Figure 18.1.

Figure 18.1: Currency swap



Currency Futures

A currency futures contract is an agreement to purchase or sell a standard quantity of foreign currency at a pre-determined date.

Futures contracts are "exchange traded" derivatives. That means that they are bought and sold on organised exchanges such as the London International Financial Futures Exchange (LIFFE). As such, there are certain rules affecting the way in which they are transacted, and some specific terminology associated with them.

- Futures contracts on a particular exchange are all of a standard size. For example, on the IMM Chicago Exchange, the standard size sterling contracts are for £62,500 and those for yen are for YEN12.5m. Thus, in order to hedge an exposure of £½ million, it would be necessary to take out eight contracts, each of which would be for £62,500.
- Exchange traded contracts – whether futures or options – all have pre-determined maturity dates on which delivery of the underlying asset occurs. For example, the contracts quoted on the Chicago Exchange relate to delivery dates at the end of March, June, September and December.
- The vast majority of futures contracts are not delivered, but are closed out. This is a process whereby the commitment entered into to buy the currency underlying the contract is cancelled out by taking an opposite position in the market – i.e. entering into a contract to sell the same quantity. Any gain or loss from closing out can be set against movements in the exchange rate.

Hedging with futures works as follows. A UK company exporting to the USA and invoicing in US dollars, would need to hedge against a rise in the exchange rate (sterling strengthening relative to the dollar) in the period before payment is received. If we assume that payment is due in two months' time, the exporter will need to sell dollars then in exchange for sterling. The strategy would be, therefore, to take out a three month sterling futures contract and close it out in two months' time – i.e. buy sterling futures now, hold them for two months and then sell them to cancel out the obligation to

deliver the underlying currency. Any profit on the contract (the difference between the buying and selling prices) will offset any loss on the dollars received from an exchange rate rise over the period.

We can illustrate the process in more detail by reference to the actions of a speculator who is anticipating a rise in the value of the $ against the pound. He will, therefore, take a position to sell sterling futures in anticipation that the future cost (in dollars) of buying the pounds necessary to meet the contract obligation will be less than the proceeds of the sale under the contract.

If the current spot rate is $1.700/£ and December sterling futures are trading at $1.675/£, what will be the gain or loss on five sterling futures contracts if the spot rate in December is $1.600/£? (The standard size of sterling futures is £62,500.)

- Sale of five December contracts (each of which is for £62,500) at the agreed rate of $1.675/£ results in proceeds of:

  $5 \times £62{,}500 \times \$1.675 = \$523{,}437.50$

- Purchase of the equivalent amount in sterling in December at the spot rate of $1.6/£ results in an outlay of:

  $5 \times £62{,}500 \times \$1.6 = \$500{,}000$

- The gain on the transaction is $23,437.50 or, converting this into pounds at the spot rate, £14,648.

The advantage for the speculator of using the futures contract compared to the alternative of buying sterling at the current spot rate is that he only needs to put down a small deposit (called a margin account) as opposed to an "up front" investment of $531,250 (£312,500 x $1.7).

Hedging using futures and forwards contracts

We can also consider the difference between a hedge using forward contracts and a hedge using futures contracts.

In December, a UK exporter invoices its US customer for $407,500 payable on 1 February. The exporter needs to hedge against a change in exchange rates whereby sterling becomes stronger relative to the dollar and he receives less pounds than now upon exchange of the dollars received in February. To hedge this exchange rate exposure, the company could take out either a forward contract or a futures contract. Which would be more appropriate given the following rates?

In December:

Spot rate	$1.6275 – 1.6295/£
February forward rate	$1.6250 – 1.6275/£
March sterling futures contracts (Contract size is £62,500)	$1.6300/£

Those applying on 1 February:

Spot rate	$1.6370 – 1.6390/£
March sterling futures contracts	$1.6355

Using a forward contract would require the exporter to commit to the sale of the dollar receivables (i.e. $407,500) at the February forward price of $1.6275/£, resulting in proceeds of:

$$\frac{\$407{,}500}{1.6275} = £250{,}384$$

The futures contract hedge would require the exporter to take a long position in sterling futures – i.e. a commitment to buy sterling at the rate of $1.6300/£ – with the intention of closing out the contract on 1 February, prior to the receipt of the dollars. If sterling does strengthen against the dollar, this position will result in a gain. However, if the exchange rate falls, then the exporter will lose on the futures contract, but gain in the cash market.

The number of sterling futures contracts necessary to cover the exposure is:

$$\frac{\$407{,}500}{1.6300} \times \frac{1}{£62{,}500} = 4 \text{ contracts}$$

The gain/loss on the futures transaction is calculated as follows:

- Buy four March contracts in December at $1.6300/£:

  4 x £62,500 × $1.6300 = $407,500

- Sell four March futures contracts in February at $1.6355

  4 x £62,500 × $1.6355 = $408,875

- Gain through closing out:

  $408,875 – $407,500 = $1,375

  Converting this into sterling at the February spot rate gives a gain of:

  $$\frac{\$1{,}375}{1.6390} = £839$$

The total proceeds from the futures hedge is calculated by adding this gain to the proceeds of the exchange of the dollars received on 1 February at the then current spot rate of 1.6390$/£:

$$\frac{\$407{,}500}{1.6390} = £248{,}627 + £839 = £249{,}466$$

This is marginally worse than the hedge using the forward contract.

Currency Options

A currency option gives the holder the right, but not the obligation, to buy or sell a specified amount of currency at an agreed exchange rate (the ***exercise price***) at a specific future date.

Using the options market to hedge exchange rate exposure sets a limit on the loss that can be made in the case of adverse movements in exchange rates, but also allows the holder to take advantage of favourable movements.

There are a number of different types of option contract available on the various options exchanges around the world (the main ones being the LIFFE, New York, Philadelphia, Montreal and Chicago exchanges). As with futures contracts, these organised exchanges offer standard format options in which the main elements of the contract are pre-determined:

- size – each currency option contract being in denominations of exactly half of those for futures contracts (thus, the standard contract sizes for sterling options are £31,500);
- exercise price – as determined by the market; and
- option period – with an expiry date usually of three months (or in multiples of three months).

It is also possible to establish option contracts outside of the organised exchanges. Such options are known as "***over the counter***" (OTC) options, and the individual elements – size, exercise price, expiry date – maybe negotiated and agreed between the buyer and seller.

Options tend to be more expensive than other derivatives since they offer the possibility of making gains should the movement in the underlying asset be favourable (in contrast to futures and forward contracts).

(a) General principles of options

There are two types of option contract:

- ***Call option***

  This is an option to ***buy*** currency.

  The buyer of a call option (said to be holding a ***long call***) is anticipating that exchange rates will rise. He will only exercise the option (i.e. buy the currency) if the spot rate of the currency is above that specified as the exercise price.

  The risk exposure is limited to the amount of the premium in the case of the exchange rate falling below the exercise price, whereas the potential gain is the difference between the spot rate and the (lower) exercise price.

  The seller of a call option is said to be holding a ***short call***. This position is the exact opposite of the buyer's position. He is obliged to sell the currency at the exercise price, but will only have to do so where the option is exercised by the buyer – i.e. if the spot rate is above the exercise price.

  The potential profit is limited to the price of the option, but there is exposure to the risk of having to sell the currency at a loss.

- ***Put option***

  This is an option to ***sell*** currency.

  These will be purchased where it is anticipated that the exchange rate may fall. The buyer of a put option (a long put) will only exercise the option (i.e. sell the currency) if the spot rate falls below the exercise price. This establishes a ceiling on any loss incurred if the option is not exercised, but allows profits to be taken if the spot rate falls and the option is exercised.

  The risk exposure is limited to the amount of the premium in the case of the exchange rate rising above the exercise price, whereas the potential gain is the difference between the exercise price and the (lower) spot rate.

  The seller of a put option is said to be holding a ***short put***. This position is, again, the exact opposite of the buyer's position. He is obliged to buy the currency at the exercise price, but will only have to do so where the option is exercised – i.e. if the spot rate is below the exercise price.

  Again, the potential profit is limited to the price of the option, but there is exposure to the risk of having to buy the currency at a loss.

(b) Hedging with currency options

The following example illustrates their use. Again, you need not be too concerned with the details, but just get to grips with the general principles.

At the beginning of July, a UK company purchased goods to the value of $250,000 from its US supplier on three months' credit, payable at the end of September.

Because the company needs to pay for the goods in dollars, it needs a strategy which enables it to sell pounds and buy dollars. The two choices, then, are a long put or a short call in sterling

options. The short call, though, can only provide protection against exchange rate losses up to the cost of the premium, so the favoured strategy would be a long put.

We shall assume the following exchange rates:

July	\$1.62/£
September	\$1.55/£

The relevant sterling options offered on the Philadelphia exchange (with standard contract sizes of £31,500) are at the following prices:

Strike price	September puts
1.6	2.32
1.61	2.65
1.62	3.22

In this case, the company decides to buy a September put option with a strike price of \$1.6/£. It could have opted for a different strike price, but this would have incurred higher premiums (albeit for a higher degree of protection).

The strategy works in the following way:

- The company needs to raise \$250,000 which, at the exercise price of \$1.6/£, equates to £156,250. To cover this amount, it will need to purchase five standard contracts. The premium paid will be:

  $$\left(\frac{2.32}{100} \text{ x } £31{,}250\right) \times 5 = \$3{,}625$$

  In sterling, at the current exchange rate, that is:

  $$\frac{3{,}625}{1.62} = £2{,}238$$

- Because the spot exchange rate has declined during the period (the dollar having strengthened), it is advantageous to exercise the put option – i.e. less pounds will need to be exchanged at the exercise price than at the spot price to buy the required amount of dollars.

  Total proceeds from exercising all five option contracts:

  $$5 \times £31{,}250 \times \$1.6 = \$250{,}000 \text{ (matching the liability)}$$

  The net sterling cost of the transaction will be:

  $$£156{,}250 - £2{,}238 = £154{,}012$$

If the option was not exercised, then the liability in dollars would need to be realised by selling sterling on the spot market. The cost involved here would be:

$$\frac{\$250{,}000}{1.55} = £161{,}290$$

Thus, using a long put results in a saving of:

$$£161{,}290 - £154{,}012 = £7{,}278$$

Money Market Hedge

The money market can be used to hedge against exchange rate fluctuations by borrowing an amount in foreign currency equal to the value of, say, invoiced exported goods, exchanging it for the domestic currency at the spot rate, and then using the receipts from the customer to repay the loan.

Effectively, this method uses the matching principle we saw earlier in respect of internal hedging, but applies it to the creation of an asset/liability in the money market, to match the liability/asset which needs to be hedged.

Thus, a UK exporter due a sum of dollars in three months' time may eliminate the exchange rate exposure by borrowing the sum of dollars at the outset – creating a matching liability. It can then exchange the dollars for sterling at the current spot rate, fixing the exchange rate on the transaction. The sterling can then be invested for the three months. If the money markets and the foreign exchange markets are in equilibrium, we can expect that interest rate parity holds and the interest earned on the sterling investment will offset any change in the exchange rate. The dollars received can be used to pay off the loan, plus interest accrued, in three months' time. This should, then, provide the same result as a forward currency hedge.

Appendix - International Business Examination

GUIDELINES FOR CASE STUDY PREPARATION AND ANALYSIS FOR INTERNATIONAL BUSINESS

The ABE wishes to acknowledge its thanks to Brian Kenny, Lecturer in Business Studies, and Professor Emeritus, Huddersfield University, for the preparation of these guidelines.

Introduction

The application of Strategic Management and Business Policy theories and concepts to real-world situations through case study method contributes to the development of complex thinking skills and an appreciation that a number of perspectives to a problem may exist.

The objectives behind the case study approach to Strategic Management and Business Policy teaching and learning cover the following three broad areas:

- To provide an understanding of the approach to strategic decision-making, and the responsibilities of top management.
- To provide a vehicle for the application of previously acquired 'specialist' knowledge in an integrated fashion and to appreciate the relationships between the functional areas of the organisation.
- To develop problem-solving skills.

Preparation

There are a number of different approaches to case study preparation and each student must develop his or her own method of approach as there is no 'best' way. As a minimum, however, the model presented here can act as a guide. The basic steps in case analysis should provide a common framework for the student to organise and apply themselves to the variety and complexities of the situations that are presented.

Within the constraints of the information imparted in each case, you should attempt to:

1. ***Become familiar with the story line***. This requires at least two detailed readings of the case.
   - Firstly, read the case through quickly to obtain an overview of the nature of the organisation and its environment. Don't worry too much about the details of the case at this stage.
   - Read the case again more slowly in order to identify any common-thread themes or major issues.
   - Then read the case a third time. This time sift carefully through the material and attempt identify the key strategic factors facing the organisation. Where appropriate, consider the relevant theories, concepts and tools of analysis that are likely to be needed for an in-depth analysis on the following lines.
2. ***Appraise and evaluate the organisation and its environment.*** This requires you to draw upon and apply the analytical tools and the theoretical and conceptual knowledge concerning business organisations and the environment in which they operate.

   In respect of the organisation, for example, this requires you to identify and evaluate it's mission, objectives and strategy. With regard to its environment, you need to identify the

opportunities and threats facing the organisation as demonstrated through an analysis of macro and micro environments.

3. ***Pinpoint significant problem areas.*** At this stage the 'diagnosis' should follow on from the identification of 'symptoms'. For example, it is meaningless to state that 'sales have fallen' without some attempt to address the underlying cause(s). It goes without saying that the appropriate evidence should also be presented.

   It is helpful to group problems under their respective functional areas, as interrelated problems will more readily be detectable and the underlying causes narrowed down to one or two sources. A diagnosis which presents several seemingly separate discrete problem areas may well be based on a superficial analysis and probably unsafe for recommending effective courses of action should this be a requirement.

   There may be the tendency to regard certain conditions as problematic, such as competition or seasonality affecting sales performance. These should be seen as factors to be accepted and acted upon, rather than as significant problem areas to be resolved.

4. ***Consider possible solutions to the problems identified.*** Suggestions can only be meaningful if steps 1, 2 and 3 have been implemented in a thorough and logical manner. As noted above, it is essential to consider the underlying causes of the problems and rarely is it the case that a recommendation can only be made by identifying and evaluating alternative courses of action.

   For example, strategy recommendations generally require the best match of opportunities with the organisation's strengths (capabilities) as identified, and this is only meaningfully achieved through a process of careful elimination.

Preparing for and Answering Examination Questions - Some Do's and Don'ts

For unseen examinations based on a previously issued case, it is essential that a complete and thorough analysis is carried out as described above, in order to be prepared for a full range of questions - in whatever order they may come and however they may be worded. Attempting to pre-empt questions in advance may subsequently lead to 'dumping' of inappropriate analysis under a question, just for the sake of using what has been pre-prepared.

- Stick to the line of questioning!
- Read the question very carefully to find what the Examiner requires in the answer.

Attempting to apply concepts which are inappropriate can also lead to a similar situation. For example, with little or no industry data in a case it is pointless, say, to apply Porter's 5-force model. However, the underlying principles may be called upon to make a point of analysis, just as one could make some useful assumptions about a product's life cycle in the absence of relevant data.

Conversely, be prepared to act upon the information provided as fully as possible. If for example, financial and market/industry data are given, these will need to be addressed at least within the context of a strategic analysis, by identifying performance indicators and competitive positioning, etc. Likewise, information on people and structure will call for relevant, conceptual treatment.

The best advice is to avoid 'generic analyses' and stick to the specific problems and issues identified and, most importantly, refrain from reviewing or regurgitating chunks of the case background just for the sake of it.

Some Useful Tips

Before the Examination:

- Set aside sufficient preparation time to study and analyse the case.
- Use the range of strategic concepts and analytical techniques as dictated by the case contents.

In the Examination:

You are allowed to take into the examination books and notes you have prepared beforehand but you are only allowed to submit material written during the examination.

- Stick to the question line and avoid generic analyses, repetition, regurgitation and analyses 'dumping'.
- Avoid making broad generalisations.
- Make only reasonable assumptions.
- Illustrate your answer with charts, diagrams and tables where appropriate.
- Consider the strategic implications of your data analyses, e.g. financial analysis.
- Substantiate and justify solutions/recommendations where called for. Often students do not write down sufficient reasons and background for the answers they have given.

ABE CASE STUDY, EXAMINATION PAPER AND SUGGESTED ANSWERS

The case study from the ABE June 2001 examination is set out below as an example of a typical International Business case. The preparation and answers that the Examiner expects from students is also included.

THE ASSOCIATION OF BUSINESS EXECUTIVES

ADVANCED DIPLOMA – BUSINESS ADMINISTRATION

JUNE 2001

CASE STUDY IN BUSINESS POLICY

LAFARGE AND THE ASIAN CEMENT INDUSTRY

This is an open-book examination and you may consult any previously prepared written material or texts during the examination.

The Association of Business Executives
William House
14 Worple Road, Wimbledon, London SW19 4DD
Tel: 020 8879 1973 Fax: 020 8946 7153
info@abeuk.com www.abeuk.com

On 13 October 1997, French based Lafarge launched a take-over bid for 100% of the shares of British company, Redland plc, the world leader in roofing tiles manufacture, at a price of £3.20 per ordinary share, equivalent to a total price of £1,669 million. In the following November, Lafarge raised its bid to £3.45 per ordinary share, equivalent to a total of around £1.8 billion (equivalent to FRF (French francs) 17.6 billion). As a result, Redland's Board of Directors recommended its shareholders to accept the Lafarge offer.

Lafarge had a broad range of businesses in the construction materials sector, enabling it to play a part in every major phase of the construction process including civil engineering, structural works, interior works, facades, floors, partitions, ceilings, finishings and interior decoration. The Group operated world-wide and its products included cement, concrete, aggregates and gypsum. The acquisition of Redland in 1997 represented a major stage in Lafarge's development and, as a result, the Group generated sales of FRF 61.5 billion and employed 65,000 people world-wide in 1998. It had progressed from being world number three to world number two in concrete and from being the world's fifth-ranking producer of aggregates to world number one. The acquisition gave the company a new business, roofing, in which it became world number one and the world's top-ranking producer of concrete roof tiles and the foremost European producer of clay roof tiles.

During the 1930's Redland had pioneered a process of extruding concrete roof tiles through a continuously moving machine which replaced the previous system whereby the cement and sand mixture was simply pressed into shape using wooden moulds. The company embarked upon an expansion strategy which involved joint ventures in the Far East and South Africa and, in the early 1950's, West Germany. Redland technology, based on the original extrusion process, was central to these and subsequently similar joint ventures, even into the 1990's. Appendix 1 provides some information on the process.

In 1996, Redland's interests in Malaysia and Thailand performed well in meeting the demands of their rapidly growing markets in which C I Holdings in Malaysia and CPAC Roof Tile in Thailand both enjoyed commanding market positions. Investment was made to expand the Group's operations in Indonesia to meet the growing demand in that market. In Japan, an investment programme was underway to reduce costs and improve product quality to supply the high value Japanese market. In 1995, the latter suffered from a sharp decline in general economic confidence and also the aftermath of the Kobe earthquake which prompted a short term switch to lighter roofing products.

Whilst sales of roof tiles in China remained at relatively modest levels, the business continued to build its sales through the start-up phase and the opening of a sales and distribution office in Beijing. A second plant, at

Shaoxing near Shanghai, was successfully completed and commissioned. The first plant at Sanshui, near Guangzhou, made improvements to its operating efficiency while the difficult conditions for distributing products in China were progressively being overcome (see Appendix 2 for a full listing of Redland's joint ventures and subsidiary operations as at 1997).

The Integration of Redland into Lafarge

Integration teams were set up in December 1997 to prepare the ground for Redland's concrete and aggregates operations to merge smoothly and for its roofing products to be transformed into a fully-fledged Lafarge business. The teams were organised by sector (North America, United Kingdom and France for aggregates and Europe and Africa-Asia for roofing), co-ordinated by a central team and monitored by a steering committee made up of the Group's senior executives, under the chairmanship of Bertrand Collomb, Lafarge's chairman and chief executive. The six-month integration programme was designed to provide a structure in which the new teams and units could define the strategies, fix the objectives and implement the action programmes that would make the acquisition rapidly successful. Asked about his objectives for Redland, Lafarge chairman and chief executive commented:

> 'In the first instance, becoming more competitive and profitable, improving the balance of our portfolio of businesses and reducing our exposure to geographical risks. This acquisition, which is the largest ever made in the history of Lafarge, substantially increases our size and strengthens our leadership positions in our businesses. But what really counts is not size; it is having competitive and profitable positions and as a consequence creating value for our shareholders.
>
> On the one hand, we will create value from the Redland acquisition as a result of synergies in the aggregates sector and achieving greater professionalism and industrial excellence in this business area. On the other hand, the Redland roofing business is expected to rally from the adverse effects of a two-year slump on the German market and to make a marked improvement in profitability thanks to cost reductions, promotional efforts and vigorously applied strategic moves. We also expect it to expand in Eastern Europe and the newly industrialised countries, with the backing of the rest of the Group.
>
> As of 1998, the Redland acquisition will have a positive impact on Lafarge's financial results. But action programmes in the process of being set up should show a margin of improvement for operating income in Redland business areas of more than one billion francs.

We have given ourselves six months to integrate Redland in the Group. Since 15 December 1997, Lafarge and Redland teams have been working on defining integration programmes to pave the way for a smooth merging of our concrete and aggregates operations in each country and to establish roofing as a full-fledged division of Lafarge. From the outset, the work consists in instituting common work procedures and consolidating an abundance of financial and accounting data. We must also very rapidly achieve a high level of mutual knowledge and understanding, so that we can derive the greatest possible benefit from the complementary structures of our businesses around the world. This work will enable us to adjust the strategies and positioning of each of the businesses. Speed is the key to success because, for employees and customers alike, it is important both to end uncertainty and respond to expectations rapidly. That is why we want to move fast, but without losing sight of our respect for people and for cultures. The quality of this integration process will determine whether or not we achieve our objectives and are successful in our future operations.'

Developments in 1997

Lafarge maintained its strategy of developing and optimising its business activities, with the aim of confirming the Group as world leader in construction materials. The implementation of this ambition involved international development and exploiting all opportunities for profitable growth, constantly improving the Group's industrial performance, and broadening its range of products. These strategies were put into practice with a strong requirement for competitiveness and a desire to create maximum shareholder value.

The acquisition of companies enabled the Group to strengthen its presence in new markets and extend its positions in both developing countries and the major Western markets (United States, Germany, United Kingdom) and to achieve its primary objectives of consolidating its leadership and becoming yet more international: it now operates in 60 countries, in contrast to only twelve a decade ago, and two thirds of sales were generated outside France in 1997, as against only one third ten years ago.

The goals of Lafarge's development policy include maintaining and improving its positions in cement, aggregates and roofing, improving the profitability of concrete, becoming a world leader in gypsum, and building up top-ranking international positions in speciality products.

Enlarging its portfolio of businesses and benefiting from a particularly well-balanced geographical spread of sales, Lafarge both increased its growth potential in developing countries and consolidated its operations in the major Western markets (United States, Germany, United Kingdom). Its objectives included developing its industrial positions and enhancing its reputation in these markets, boosting profitability and creating shareholder value, together with expanding its range of skills to further improve the service it offered to its customers.

Alongside the long list of acquisitions made in 1997, which included Romcim in Romania, Malogoszcz in Poland, Cementos Molins in Spain and South America and Hoganas Eldfast in Sweden, the company launched a programme to modernise production facilities in North America and applied a cost-reduction policy in France, Austria, Spain and North America which resulted in nearly FRF 300 million of savings. The year also saw the implementation of a new Group research and development organisation.

These policies produced sharply improved results and all of the Group's businesses made progress in markets that in most cases showed positive trends. In Western Europe, the Group benefited as the market slump came to an end (except for Germany) and prices held up well. In North America, record levels of business were achieved in the United States, along with continued recovery in Canada. The company reaped the benefits of both a further increase in cement prices and good results from the gypsum operation. All markets in the newly industrialised countries and Central and Eastern Europe recorded growth as did all the businesses of cement, concrete, aggregates, gypsum and speciality products. The Asian crisis did not produce a significant effect on figures for 1997, although operations in South-East Asia were limited. The company was also active in India and China which had been spared the crisis.

Lafarge's sales by activity and geographical area in 1997 (excluding Redland) were:

	%		%
Cement	46	Europe/Med. Basin	58
Concrete	21	North America	27
Aggregates	8	Latin America	8
Gypsum	10	Africa/Asia	7
Speciality Prods.	15		

In 1998 Lafarge continued to implement the strategies that it had defined five years previously and which were founded on three basic principles:

* creating value from current operations
* expanding all businesses geographically
* broadening the range of products

Factors Affecting Performance

The decline of the main Western European construction markets came to a halt, with the exception of the German market, where there was another year of recession. The favourable evolution of the markets was due to good overall levels of house building and growth of the renovation segment. Public spending throughout Western Europe, however, was still strictly controlled by the various governments, which focused on reducing public deficits. Against this background, French cement imports stabilised at their 1996 levels and decreased in most other Western European countries, allowing Lafarge to consolidate its sales. Results in gypsum in Europe improved substantially, primarily because of strong growth in volumes of gypsum wallboard.

In North America, the construction market performed well, with the United States cement market enjoying its sixth consecutive year of growth, and market recovery continued in Canada. There were **also** further rises in cement prices. The newly industrialised countries (particularly Turkey, Morocco, Brazil and Venezuela) and the countries of Eastern Europe significantly increased their contribution.

Organisation

To gain maximum benefit from its Group status, Lafarge systematically encouraged an international outlook and the acceptance of mobility among a growing number of its employees. The latter were considered to be the repositories of know-how and through them that know-how was transferred to the various countries in which the Group operated. In just 10 years, the number of international managers in the Group had increased fivefold. Excluding former Redland employees, more than 400 managers worked outside of their home country, and in 1997 the emphasis was on offering international opportunities to young employees following experience in their home countries. Lafarge's management structure consisted of several vice presidents with responsibility for the functional activities covering finance, human resources, strategy and marketing, and research and development (see Appendix 3).

Because of the growth and increasing diversity of the Group, there had been greater efforts than ever to formalise the policies and practices of human resource management. This primarily concerned career management, recruitment, international mobility, and detecting and managing potential. A language policy was defined in 1997, on the basis of French and English training programmes that would allow this policy to become fully operational by late 1999.

Innovation Research and Development Policy

A major aim was the development of construction materials to bring greater safety, comfort and aesthetic appeal to everyday life; also, to broaden the range of products and services, meet the quality challenge, constantly improve the performance of production facilities and foster the technological leaps that would enable the development of future materials. In order to achieve its goals, the Lafarge Group carried out reorganisation of its research and development set-up, with an international team of top-quality researchers. The drive for innovation produced about fifty new products in 1997.

To keep pace with demand from the market place and from the major players in the sectors of new construction, building renovation and public works, Lafarge made constant improvements to the technical performance of its products. The ease and reliability of application of materials were as much factors of competition as performance and durability. Modern construction materials required to be designed as systems rather than a simple addition of components.

Lafarge had acquired and fostered an expertise that ensured continuous progress in plant productivity, competitiveness, environmental protection and product quality, and which was also brought to bear on plant modernisation and rehabilitation projects. The Group carried out leading-edge research into forms of construction such as the association of mineral and organic products. For example, formulation of new concrete product families higher in performance and of better appearance: concretes that could be pumped long distances, self-levelling concretes, self-compacting concretes, concretes with improved technology and concretes of the future. This new, ultra high-performance type of concrete reflected a complete technological breakthrough with properties of strength, durability and appearance that made it an extremely versatile material with vast potential, particularly for bridge building applications.

More than 400 people were employed on Research and Development at the Central Research Laboratory or in the various applications laboratories operating at the level of Group subsidiaries and divisions. The new organisation intended to create an increasingly dense network of competencies within the Group to provide ongoing scientific training to personnel, whilst updating and internationalising knowledge and its application in a variety of geographical environments.

APPENDIX 1

REDLAND TILE MANUFACTURE BASED ON THE EXTRUSION PROCESS

Although concrete tiles of a sort had existed since the 1840's, the process was really pioneered by Redland after the first world war. Marley started production at about the same time and also very close, geographically, to Redland.

Concrete tiles were initially made by hand, in plain tile form, and there was no patent cover available to either company at this stage. Even so, the handmade product was very competitive against slate and clay. From the outset the handmade concrete tile possessed its characteristic benefits over slate and clay:

* dimensional accuracy
* wider colour range
* price advantage
* better technical performance through higher strength, lower weight and much better frost resistance
* geographic scope, due to more widely available raw materials, to make concrete tiles anywhere justified by the market.

Complementing these advantages, the extrusion process was introduced and developed for plain tile making prior to the second world war. There was, however, no patent cover at this stage.

With its considerable production cost advantage, concrete started to gain share strongly against slate and clay, both of which remained manual processes before the second world war. The moulding of clay tile was notably less efficient than the extrusion process used for concrete. After the second world war came the first development of an interlocking concrete tile in the form of Redland's "49" tile (in 1949). This was a major step although the concept of an interlocking design was already established in the clay tile market. Moreover, the concrete tile enjoyed the protection afforded by registration of the design. Marley followed with its own interlocking ranges, modified in shape and detail to avoid infringement of Redland's rights. By this stage, the interlocking concrete tile had become a very efficient way of covering a roof through the use of a single layer of accurate and low cost tiles.

International Growth
The concrete tile market expanded rapidly from this point. In 1950, Redland introduced *Double Roman*, the most popular model in the UK and elsewhere. This was followed in the early 1950's by *Renown, Regent* and other models. The expansion was based on offering wide choice of colour, shape and profile.

It therefore provided a new concept of roof design to architects. Throughout, Redland combined a strong business strategy with the developing technology. The success of the early 1950's therefore led to new UK plants and to overseas licensing of the process. This was highly opportune timing given the need to rebuild post-war Europe. The alliance with Braas (1954) was a key building block in Redland's international growth and a precursor to others in France (Saint Gobain) and elsewhere.

Technology, Competitive Advantage and Ease of Copying
Technical process details are only available to joint venture licensees. These benefit from technology in which:

* product design is optimised both for processing and end performance.
* extrusion provides speed and accuracy of tile forming.
* effectively a continuous process. It is the tile forming which is the "clever" aspect.
* highly developed expertise in formulation balances processing characteristics and end performance.

It is true to say that the process is relatively easy to copy. It is fairly straight-forward and is patented only as to specific areas of the plant. However, design protection always exists and it is difficult for competitors to achieve Redland's high levels of efficiency. Redland has always managed to maintain its innovative and marketing edge. It has also stayed more closely focused on concrete tiles as opposed to derivative businesses.

REDLAND'S PRINCIPAL OPERATING COMPANIES – 1997

	Principal activities	% beneficial interest in equity
UNITED KINGDOM		
Redland Aggregates Limited, Leicester	Sand and gravel, stone quarrying, road surfacing materials, road surfacing, burnt products and concrete products	100
Redland Bricks Limited, Staffordshire	Clay bricks	100
Redland Distribution Limited, Nottinghamshire	Road transportation services	100
Redland Tile and Brick Limited, Co Antrim	Concrete roof tiles, pipes and bricks, and sand lime mortar	100
Redland Properties Limited, Surrey	Property management	100
Redland Readymix Limited, Leicester	Ready-mixed concrete	100
Redland Roof Tiles Limited, Surrey	Concrete and clay roof tiles and Cambrian interlocking slates	100
Redland Technologies Limited, West Sussex	Research and development and engineering services	100
Ready Mixed Concrete (Eastern Counties), Essex	Ready-mixed concrete	50

P.T.O.

	Principal activities	% beneficial interest in equity
CONTINENTAL EUROPE		
AUSTRIA		
Bramac Dachsteinwerk GmbH, Pöchlarn	Concrete and clay roof tiles	25.4
Schiedel Kaminwerke GmbH, Wartburg	Prefabricated chimney systems	50.8
Ziegelwerke Gleinstatten GmbH	Clay roof tiles	12.7
BELGIUM		
RBB NV, Tessenderlo	Concrete roof tiles	50
DENMARK		
B C Danmark A/S	Concrete roof tiles	50.8
Dan Tegl Tag A/S, Aalborg	Clay roof tiles	50.8
FRANCE		
Redland Granulats SA, Rungis Cedex	Sand and gravel, stone quarrying, ready-mixed concrete, road surfacing	100
Coverland SA, Malmaison Cedex	Concrete and clay roof tiles	66.7
GERMANY		
Braas GmbH, Oberursel	Concrete roof tiles, flat roofing membranes and plastic products for the construction industry	50.8

APPENDIX 2 continued

	Principal activities	% beneficial interest in equity
RuppKeramik Gmbh, Buchen-Hainstadt	Clay roof tiles	50.8
Schiedel GmbH Co, Munich	Prefabricated chimney systems	50.8
HUNGARY		
Bramac Kft., Veszprém	Concrete roof tiles	14.5
ITALY		
Braas Italia S.p.A., Chienes	Concrete and clay roof tiles and flat roofing products	50.8
NETHERLANDS		
Redland Dakprodukten BV	Concrete and clay roof tiles	100
NORWAY		
Zanda A/S, Slemmestad	Concrete roof tiles	50.8
PORTUGAL		
Lusoceram-Empreendimentos Ceramicos SA, Lisbon	Clay roof tiles and clay blocks	47
SPAIN		
Redland Ibérica SA, Madrid	Concrete roof tiles	47
Industrias Transformadoras del Cemento Eternit SA, Madrid	Concrete and clay roof tiles	47
SWEDEN		
Zanda AB, Sennan	Concrete roof tiles	50.8
Vittinge Tegel AB, Morgongäva	Clay roof tiles	50.8

	Principal activities	% beneficial interest in equity
SWITZERLAND		
Braas Schweiz AG, Villmergen	Concrete roof tiles	50.8
NORTH AMERICA		
CANADA		
Redland Quarries Inc, Ontario	Stone quarrying, road surfacing materials and calcined dolomite	100
UNITED STATES OF AMERICA		
Redland Genstar, Maryland	Stone quarrying, sand and gravel, road surfacing materials, road surfacing, ready-mixed concrete	100
Monier Inc, California	Concrete and clay roof tiles	100
Redland Brick Inc, Maryland	Clay bricks	100
Redland Stone Products Company, Texas	Stone quarrying, sand and gravel, road surfacing materials, ready-mixed concrete and burnt lime	100
Western Mobile Inc, Colorado	Stone quarrying, sand and gravel, road surfacing materials, road surfacing and ready-mixed concrete	100

	Principal activities	% beneficial interest in equity
ASIA		
CHINA		
Sanshui Redland Building Materials Co Ltd, Guangzhou	Concrete roof tiles	80
INDONESIA		
PT Monier Indonesia, Jakarta	Concrete roof tiles	60
JAPAN		
Nippon Monier Co Ltd, Osaka	Concrete roof tiles	60
MALAYSIA AND SINGAPORE		
CI Holdings Berhad, Kuala Lumpur	Concrete roof tiles, concrete paving, taps and road surfacing materials	25.7
THAILAND		
CPAC Roof Tile Co Limited, Bangkok	Concrete roof tiles	24.8
MIDDLE EAST		
BAHRAIN		
Delmon Ready Mixed Concrete Products Co WLL and Delmon Precast Co WLL, Manama	Ready-mixed concrete and precast concrete	49

	Principal activities	% beneficial interest in equity
LEBANON		
Redland Readymix Sarl	Ready-mixed concrete	50
OMAN		
Readymix Muscat LLC and Premix LLC, Ruwi	Ready-mixed concrete	40
QATAR		
Readymix Qatar WLL and The Qatar Quarry Co Ltd, Doha	Ready-mixed concrete and stone quarrying	49 and 25 (respectively)
SAUDI ARABIA		
Qanbar Steetley (Saudi) Limited, Dammam	Ready-mixed concrete	50
UNITED ARAB EMIRATES		
Readymix Gulf Limited, Sharjah	Ready-mixed concrete	40

APPENDIX 3

LAFARGE BOARD AND EXECUTIVE MANAGEMENT

In addition to the Board of Directors, which is made up of fifteen senior directors, the management comprised the following executive positions, all at vice-president level.

Finance
Jean-Pierre Cloiseau, FINANCE; Patrick Alix, VALUE CREATION PROJECT; Denis Fabre, GROUP AUDIT; Roland Ferdegue, BUSINESS DEVELOPMENT; Alain de La Bigne, MIS; Olivier Luneau, GROUP CONTROLLER; Dominique Malige, IT; Andre-Gilles Taithe, LEGAL AFFAIRS; Patrice Tourliere, FINANCE AND TREASURY

Human Resources and Communication
Louis Dugas, SOCIAL POLICY; James Nealis, INTERNATIONAL DEV. OF HR; Didier Tresarrieu EXECUTIVE PERSONNEL MANAGEMENT; Jacques Suart, GROUP CORPORATE COMMUNICATION

Strategy and Marketing
Dung Van Anh, CEMENT STRATEGY; David Seroux, STRATEGIC MARKETING

Research and Performance
Christian Sacchetti, RESEARCH AND DEVELOPMENT; Jacques Henceval, CONCRETE AND AGGREGATES PERFORMANCE; Jacques Lukasik SCIENCE; Claude Rivoire, CEMENT PERFORMANCE; Frederic de Rougemont, CENTRAL RESEARCH LABORATORY

APPENDIX 4

LAFARGE

Consolidated income statement for the year ended 31 December, 1997

(IN MILLIONS OF FRENCH FRANCS UNLESS OTHERWISE INDICATED)

	1997	1996	1995
Sales	42,066	35,262	33,218
Cost of sales	(27,902)	(23,478)	(22,113)
Selling and administrative expenses	(6,036)	(5,562)	(5,225)
Gross operating income	8,128	6,222	5,880
Depreciation and amortisation	(2,571)	(2,153)	(2,002)
Share of earnings of equity affiliates	73	100	162
Gross operating income on ordinary activities	5,630	4,169	4,040
Gains (losses) on disposals	351	116	619
Other revenues (expenses)	(460)	(238)	(222)
Operating income	5,521	4,047	4,437
Net financial expenses	(604)	(522)	(552)
Income before tax	4,917	3,525	3,885
Income tax	(1,253)	(825)	(851)
Net income of consolidated companies	3,664	2,700	3,034
Minority interests	(962)	(662)	(519)
Amortisation of goodwill	(270)	(192)	(165)
Net income, Group share	2,432	1,846	2,350
Net income per share (in French francs)	27.2	20.5	26.6
Average number of shares (in thousands)	89,524	90,287	88,279

LAFARGE
Consolidated balance sheet as at 31 December, 1997
(IN MILLIONS OF FRENCH FRANCS UNLESS OTHERWISE INDICATED)

	1997	1996	1995
ASSETS			
Intangible assets	4,479	3,872	3,601
Goodwill	13,432	4,611	3,939
Property, plant and equipment	43,636	23,526	21,769
Fixed assets, net	**61,547**	**32,009**	**29,309**
Investments in equity affiliates	1,865	756	676
Other investments	3,039	4,129	2,559
Long term loans and receivables	2,575	1,513	1,316
Other long term assets	**7,479**	**6,398**	**4,551**
Inventories and work-in-progress	6,758	4,088	3,828
Accounts and notes receivable, trade	9,968	6,897	6,555
Other receivables	4,104	1,843	1,719
Accounts and notes payable, trade	(5,480)	(3,542)	(3,353)
Other payables	(10,645)	(5,138)	(5,074)
Working capital requirements	**4,705**	**4,148**	**3,675**
TOTAL ASSETS	**73,731**	**42,555**	**37,535**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Common stock	2,366	2,360	2,306
Additional paid-up capital	12,130	12,069	11,509
Reserves	12,855	11,666	11,400
Translation differences	(1,230)	(1,935)	(2,011)
Stockholders' equity Group share	26,121	24,160	23,204
Minority interests	8,776	5,305	4,629
Other equity	169	148	2,961
Total equity	35,066	29,613	30,794
Provisions	6,391	3,625	3,803
Long- and medium-term debt	33,012	10,637	6,436
Current portion of long- and medium-term debt	3,020	1,805	417
Short-term bank borrowings	1,920	169	451
Cash and cash equivalents	(5,678)	(3,294)	(4,366)
Net indebtedness	32,274	9,317	2,938
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**73,731**	**42,555**	**37,535**

LAFARGE
Five year summary of Group financial data
(IN MILLIONS OF FRENCH FRANCS UNLESS OTHERWISE INDICATED)

	1997	1996	1995	1994	1993
Number of shares outstanding (thousands)	94,663	94,403	92,251	89,910	82,241
Total equity	35,066	29,613	30,794	29,705	26,531
Stockholders' equity Group share	26,121	24,160	23,204	21,643	18,988
Stockholders' equity Group share, per share (FRF)	292.2	269.7	259.0	248.1	230.9
Net indebtedness	32,274	9,317	2,938	1,972	5,462
Consolidated income					
Sales	42,066	35,262	33,218	32,841	30,430
Net income of consolidated companies	3,664	2,700	3,034	2,724	1,983
Net income Group share	2,432	1,846	2,350	2,225	1,553
Net cash flow from operating activities	6,126	4,774	4,796	5,227	3,597
Per share data (in FRF)					
Attributable net income for the year	27.2	20.5	26.6	25.9	21.3
Cash flow from operating activities	68.4	52.9	54.3	60.9	49.6
Employees					
As at 31 December	37,097	35,232	34,819	33,233	30,572
End of year share price (FRF)	394.9	311.3	315.5	380.0	466.6
SBF* 250 Index (1982=100)	800	650	530	535	600

*French Stock Exchange

Rates of exchange (FRF) as at 31 December, 1997

	Year-end rate			Average rate		
	1997	**1996**	**1995**	**1997**	**1996**	**1995**
US Dollar (USD)	6.00	5.24	4.90	5.84	5.11	5.00
Canadian Dollar (CAD)	4.18	3.82	3.60	3.82	3.75	3.64
Deutschmark (DEM)	3.35	3.37	3.42	3.37	3.40	3.48
Peseta (ESP)	0.040	0.040	0.040	0.040	0.040	0.040
Pound sterling (GBP)	9.92	8.90	7.60	9.56	7.99	7.88

P.T.O.

APPENDIX 5

NOTE ON THE EUROPEAN CONSTRUCTION AND BUILDING MATERIALS INDUSTRIES

(Information extracted from: *Building*, December 1996, by kind permission of the publisher.)

EUROPEAN OUTLOOK

Overall the 1997 outlook for construction in Europe is a little better than this year, but the expected improvement is nothing to shout about. Europe's leading forecaster, Euroconstruct, predicts total construction output of about £550bn, which is only 0.5% above this year's level. But the good news is the economists think output will stop declining next year - this year, output is likely to be 0.3% down on 1995. Commercial and industrial work, civil engineering and refurbishment are the sectors with the best prospects for 1997, while the amount of work in housing and public sector is set to fall. Again, the countries with the highest forecast growth in construction output are in Eastern Europe - the Slovak Republic, Poland, Hungary and the Czech Republic.

In Portugal, civil engineering work is expected to grow 9%, helped by European Union infrastructure grants, and will be the main force behind a strengthening construction market. But public sector capital spending is likely to be reined back as the country tries to fulfil the Maastricht criteria to join the single currency.

The German construction industry is bracing itself for another bad year. The recession in the West is expected to spread eastwards, and total construction spending is set to fall about 2%. The housing sector is the main culprit of the downturn, with the amount of commercial and industrial work thought likely to stay the same as this year.

In 1995, UK building materials suppliers chalked up a record £3.5bn of earnings from goods exported to markets around the world, reducing the trade deficit for building materials and products by 16%. Materials giants such as plasterboard manufacturer BPB, glass producer Pilkington and leading pipe supplier Hepworth, already sell substantial amounts of their products abroad, relying heavily on European markets such as Germany and France. According to a poll of 110 construction exporters carried out by Gallup for courier firm DHL, Africa has replaced the European Union as the region with the most promising markets. The survey, published last month, found 50% of respondents thought Africa had the best export potential followed by the EU (43%) and the USA/Canada (38%). China was seen as having the least potential.

EXPECTED CONSTRUCTION OUTPUT FOR 1996 AND FORECAST FOR 1997 (£bn)

	1996 (Expected)	% change on 1995	1997 (Forecast)
Germany	171.4	-2.5	167.8
France	78.3	-1.1	78.5
Italy	60.2	2.1	62.4
Spain	41.3	2.7	43.6
UK	50.2	0.2	51.5
Denmark	10.9	4.2	11.8
Finland	7.2	2.0	7.7
Norway	8.8	2.4	9.2
Sweden	15.6	4.5	16.6
Belgium	18.0	1.5	18.6
The Netherlands	25.2	0.1	25.5
Switzerland	21.9	-4.5	20.7
Austria	23.7	-2.0	23.0
Ireland	4.4	9.2	4.9
Portugal	7.8	3.8	8.6
Czech Republic	3.9	9.4	4.6
Hungary	2.9	4.0	3.1
Poland	6.5	7.0	7.4
Slovak Republic	1.1	8.0	1.3
New homes	140.5	3.1	137.5
Private non-housing	81.9	-3.1	82.7
Public non-housing	27.4	-1.9	27.1
Civil engineering	116.7	-0.6	117.9
Refurbishment	181.0	1.7	183.1
Total	547.5	-0.3	550.2

Source: *Euroconstruct*

EUROPEAN BUILDING MATERIALS MANUFACTURERS – SELECTION OF TOP 200 COMPANIES (1996)

Rank 1996	Company	Country	1995 turnover (£m)	% increase turnover 1994-95	% turnover abroad	1995 profit (£m)
1	ASEA BROWN BOVERI	Germany	19,428	–	–	757
2	HANSON	UK	10,441	–	–	264
4	SAINT-GOBAIN	France	8,340	–6	69	500
5	SCHNEIDER ELECTRIC	France	4,969	8	76	144
6	ALCATEL CABLE	France	4,752	2	80	–302
7	HOLDERBANK	Switzerland	4,141	–9	90	315
8	LAFARGE	France	3,940	1	64	279
9	RMC GROUP	UK	3,844	–1	–	77
10	WOLSELEY	UK	3,528	16	–	245
11	PILKINGTON	UK	2,707	9	–	212
12	AKZO	Netherland	2,522	–1	–	175
13	HEIDELBERGENZEMENT	Germany	2,495	–4	58	103
14	REDLAND	UK	2,338	–10	–	373
20	READYMIX*	Germany	1,658	–1	12	57
23	CIMENTS FRANCAIS	France	1,491	–5	48	33
39	HILTI	Switzerland	993	–11	96	96
50	VAILLANT	Germany	702	–6	–	*
55	LAFARGE MATERIAUX	France	673	5	–	*
57	MARLEY	UK	667	8	–	44
79	LAFARGE BETONS	France	415	1	–	*
80	CATERPILLAR FRANCE	France	413	10	94	*
98	PLETTAC	Germany	337	21	25	29
160	L'UNITE HERMETIQUE	France	165	25	82	4
170	POTAIN	France	149	–15	57	8

* Precise information not available

APPENDIX 5 continued

Rank 1996	Company	Country	1995 turnover (£m)	% increase turnover 1994-95	% turnover abroad	1995 profit (£m)
181	ELM LEBLANC	France	137	23	26	7
184	ASAMER UND HUFNAGL	Austria	135	25	22	10
191	JUNCKERS INDUSTRIER	Denmark	126	3	70	*
200	HOVAL	Switzerland	117	–15	45	*

* Precise information not available

P.T.O.

APPENDIX 6

NOTE ON THE ASIAN CEMENT INDUSTRY (1999)
(Source: Adapted from: http://www.economist.com/archive, 28 April 2000)

The Asian miracle went hand-in-hand with a construction boom. Millions of tonnes of cement emerged from scores of huge new production plants. Between 1992 and 1997, Thailand alone built nearly three times Britain's total cement capacity. Now skylines of South-East Asia's cities are blighted by frozen cranes and rust-streaked, half-built skyscrapers. With construction at a standstill, you might think cement must be the most unwanted commodity of all.

You would be wrong. Cement was one of the top three industries for mergers and acquisitions (M&A) in Asia last year, and the interest will probably persist this year too. In 1998 total mergers and acquisitions in the region actually fell, but the cement deals involving western firms grew fivefold: there were at least 14, with a total value of more than $1 billion. Somehow, despite over-capacity in South-East Asia reckoned to exceed 25m tonnes, nearly a tenth of the production of the European Union, cement plants have turned out to be the most desirable assets in Asia.

Forget the image of a dusty commodity: over the past 15 years the cement industry has become a fast-moving, high-tech paragon of globalisation. Six multinational giants – Switzerland's Holderbank, France's Lafarge, Britain's Blue Circle, Mexico's Cemex, Germany's Heidelberger Zement and France's Ciments Francais, a subsidiary of Italy's Italcementi – are jockeying to divide up the world's markets.

Whenever an otherwise fast-growing market has an economic downturn, these multinationals go on a buying spree in an effort to extend their reach. In the mid- to late 1980s, the Europeans invaded North America and now own most of the capacity there. In the early 1990s they did the same in Eastern Europe. In 1995-97, after Mexico's peso crisis, they and Cemex snapped up most of the independent cement companies in Latin America. The Asian financial crisis gave them the opportunity to complete their global franchises. "Over the next few years, 'the big six' will take over most of the Asian cement industry – they've already started," says Harry Van Dyke, head of Asian M&A at Morgan Stanley, an investment bank.

The nature of the cement industry drives this expansion. Cement is mainly local. On land, it cannot be transported affordably further than about 400km, so plants must be near construction hotspots. The fastest-rising cities and roads are in the developing world, rather than in the home markets of European producers, so these companies must look abroad for long-term growth. To enter a market, the multinationals often have to buy a local

producer. With hundreds of independents already in place, it rarely makes sense to build from scratch.

Fear also plays a role. Cement travels well by sea and, although producers cannot make money importing it into the developing world, they can profitably export cement from it. If the big six do not buy Asia's cement makers, they risk having to compete with cheap imported cement in their home markets. Thai cement, for example, costs $12-15 a tonne to produce, and $30 to ship to the west coast of America, plus a bit more for final processing (cement is shipped in an intermediate state in case it gets wet). Because America is now in the midst of a cement shortage, it sells for $70 a tonne, offering a tempting $20 margin to any Asian producer, says Simon Francis, a cement-industry analyst at Credit Suisse First Boston in Singapore.

Yet the multinationals' motive was not just defensive. Big firms have many advantages in the cement trade. As well as access to cheaper finance, important in such a capital- intensive business, they have the technology to make better cement more cheaply and using less power, and the experience to avoid environmental problems. As odd as it sounds, says Simon Goodfellow, an analyst with ING Barings in London, "cement is a classic knowledge-management industry": the firm with the best engineers, database and communications network wins. And the global producers already have efficient shipping operations, which they can use to move cement from areas of glut to areas of scarcity, keeping prices stable and factories busy.

Most of the M&A frenzy in Asia's cement industry has been confined to South-East Asia. South Korea, a developed country, offers less growth and its market has been distorted by transport subsidies that let local producers build cement plants far from demand. Only Halla Cement is in M&A talks with foreign firms – with its main plant near a port, it can export much of its production. China is unattractive because of a problem known charitably in the industry as "product substitution": companies putting almost anything in a bag and selling it as cement (collapsing bridges are a national hazard). Taiwan avoided the worst of the financial crisis, so its firms are relatively expensive.

Today, most of the biggest deals in the region have already been done. Many were sealed near the bottom of the market when local firms were desperate to pay their huge foreign-currency debts (Thailand's Siam Cement alone owed $5 billion). Since then, prices have risen from as little as $70 per tonne of annual capacity to as much as $150 per tonne, almost the cost of building a new plant. Demand is also rising again, because of both the recovery and the infrastructure spending that governments are using to stimulate their

economies. But there are still half-a-dozen big independents in play, including Indocement in Indonesia, and at least four of 'the big six' are still buying (Holderbank has been the most active, with six completed deals; only Heidelberger has not yet announced any deals).

Even if only a few more acquisitions are announced this year, Asia's cement industry will have been transformed, with the multinationals having a stake in an estimated 60% of capacity, up from less than 20% only two years ago. At a stroke, five of the big six have sewn up what will be one of the world's biggest construction markets in the decades to come. With all the talk of property and telecoms deals, who would have guessed that dull old cement would be the liveliest game in town?

APPENDIX 7

Economic Forecasts for East Asia in 2001
(Source: Adapted from *Outlook for East Asia*, http://www.ide 18 Dec. 2000)

Assumptions about Exchange Rates
The yen's exchange rate against the U.S. dollar is predicted to average 108 yen to the dollar for 2000 as a whole. In 2001, with the continuation of Japan's economic recovery, it is assumed that the value of the yen will average around 110 yen to the dollar for the year as a whole.

In East Asia, it is assumed that the currencies of China, Hong Kong, and Malaysia will remain pegged to the U.S. dollar at their respective exchange rates of 2000. It is assumed that the currencies of the East Asian Newly Industrialised Countries (NICs), with the exception of Hong Kong, will appreciate relative to the U.S. dollar in 2001, reflecting their economic expansions.

Among the ASEAN 4 (not including Malaysia) Indonesia, in spite of adverse effects of continuing political instability, will see an economic upturn led by continuously strong dollar-denominated crude oil exports and a recovery of its manufacturing industries. As a result, it is assumed that the Indonesian rupiah's exchange rate against the U.S. dollar will pick up slightly. Given the prospects that low-interest rate policies will remain in place in Thailand and that the Philippines' political situation will become unsettled, it is assumed that their currencies will depreciate by small margins relative to the U.S. dollar.

The Economic Growth Rates of South Korea, Taiwan, and Singapore will Decelerate to Below 7% Levels due to Slowing Export Expansions
Due to the slowing expansion of exports of IT-related products, which will push their export growth rates to half the rates for 2000, all the NICs outside Hong Kong will grow at rates below the 7% mark in 2001, with South Korea's slowing to a forecast rate of 6.7%, Taiwan's to 6.1%, and Singapore's to 6.9%.

Hong Kong will Attain Stable Growth of 4.7% in 2001
In 2001, Hong Kong will also see its export growth rate decrease by half from the 2000 level. Though domestic demand will remain solid, the slowing of exports will be sufficient to trigger a type of pendulum effect, causing a sharp economic downturn from the double-digit high growth rate registered in 2000. Consequently, Hong Kong's economy in 2001 is forecast to slow to a stable growth rate of 4.7%.

In 2001, the NICs as a Whole will Enjoy a Stable Growth Rate of 6.2%
The aggregate growth rate of the NICs as a whole is forecast to be 6.2% in 2001, a rate 2.4 percentage points lower than in 2000, but still a stable one.

In 2001, General Prices in the NICs will Rise by 1.5%
Given the prospect that the currencies of South Korea and Singapore will appreciate slightly relative to the U.S. dollar, and that crude oil prices will become more stabilised than in 2000, the rates of increase of general prices in the two countries in 2001 are forecast to decrease by small margins. General prices in Taiwan in 2001 are forecast to remain stable, increasing by just 0.2%. In Hong Kong, where the downward trend of housing-related prices is expected to come to an end in 2001, the rate of increase in general prices is forecast to pick up again to 1.2%, rebounding from the minus 5.4% registered in 2000. The rate of increase in general prices in the NICs as a whole is forecast to be 1.5% in 2001, a rate 1.0 percentage point higher than in 2000.

In 2001, Exports of the ASEAN Countries other than Vietnam will Grow at Slower Rates than in 2000
Vietnam's exports are expected to increase by 10% in 2001, outpacing 2000's growth rate by 1 percentage point under the effects of a trade agreement concluded with the United States during 2000.
However, export growth rates for the remaining four ASEAN countries are expected to decrease in 2001, under the adverse effects of slowing growth rates in the United States and European economies, and a slowdown in the expansion of the global market for IT-related products. The growth rate of Indonesia's exports is expected to decrease from 18% in 2000 to 8% in 2001, that of Thailand from 21% to 16%, that of the Philippines from 14% to 9%, and that of Malaysia from 17% to 9%

In 2001, Vietnam will Attain a Growth Rate of 7.2%, Buoyed by Expanding Exports and Investment
In 2001, Vietnam is expected to see not only its exports to the United States increase, but also to see foreign direct investment start picking up again after decreasing for several years. Under the effects of these factors, Vietnam's economy is forecast to increase by 7.2% in 2001, a rate 0.6 percentage points higher than in 2000.

In 2001, Indonesia and Thailand will Continue Pacing along their Recovery Paths, Growing by 4.7% and 4.8%, respectively
In both Indonesia and Thailand, investment activities will continue to gather momentum, though their export growth rates will decrease. Consequently, their economies will continue to pick up momentum in 2001 toward steady, if not rapid, recovery, with Indonesia attaining a forecast growth rate of 4.7% and Thailand 4.8%.

Malaysia will Attain a High Growth Rate of 7.1% by Continuing its Expansionary Fiscal Policies
Malaysia's export growth rate will sustain a decrease of 8 percentage points in 2001. However, the country's expansionary fiscal policies are expected to

remain in place in succession to 2000. Consequently, its economy is forecast to attain a high growth rate of 7.1% in 2001, even though 1.7 percentage points lower than in 2000.

The Philippines' Economic Growth Rate will Decline to 3.5% under the Effect of the Peso's Depreciation and Higher Interest Rates

The political situation in the Philippines is expected to remain unstable in 2001, pushing the peso's value lower and sending interest rates upward. Given these prospects, private investment, and in particular foreign direct investment, will continue to decrease, with the result that the Philippines' economy is forecast to slow down to a 3.5% growth rate in 2001.

The ASEAN 5 as a Whole will Attain a Solid Growth Rate of 5.1% under an Inflation Rate of 4.0%

In 2001, general prices in the ASEAN 5 are forecast to rise by 4.0%, a rate 1.2 percentage points lower than in 2000, reflecting the expected slowing of inflation in Indonesia. The economic performance of the ASEAN 5 in 2001 is forecast to differ widely from one country to the next with the economic growth rates of Malaysia and the Philippines forecast to decrease, those of Indonesia and Thailand to remain comparable to those in 2000, and that of Vietnam to gather further momentum. However, the aggregate economic growth rate of the ASEAN 5 is forecast to be 5.1% in 2001, a solid rate though 0.4 points lower than in 2000.

China's Economy will Grow by 8.0% in 2001, a Rate Comparable to that of 2000

The growth rate of China's exports is forecast to drop by half from 2000's 30% to 14% in 2001, but this will be accompanied by a comparable decrease in the growth rate of imports, which is forecast to decrease from 30% to 16%. On the other hand, domestic demand will remain strong, increasing by a margin comparable to that of 2000. Consequently, China's economy in 2001 is forecast to register a growth rate of 8.0%, a rate lower than in 2000 by just 0.1 percentage points.

In 2001, the East Asian Economy as a Whole will Post a Stable Growth Rate of 6.8%, under Mild Inflationary Pressure of 1.8%

The slowing of the United States and European economies, as well as the dampening of the global market for IT-related products, which are forecast for 2001, will put a brake on the expansionary trend in East Asia's exports. The East Asian economy as a whole is forecast to attain a stable growth rate of 6.8% in 2001, a rate 1.0 percentage point lower than in 2000.
General prices for East Asia are forecast to increase by 1.8% in 2001, representing a gain of 0.7 percentage point over 2000, showing a continuing weak inflationary trend.

TABLE 1

Forecasts for GDP Growth Rates and Inflation Rates in East Asia, 2000 and 2001

	GDP Growth % (in real terms)			Inflation Rates % (measured by GDP deflator)		
	1999	**2000**	**2001**	**1999**	**2000**	**2001**
South Korea	10.7	9.3	6.7	-1.6	2.5	2.3
Taiwan	5.4	6.5	6.1	-1.4	0.1	0.2
Hong Kong	3.1	10.2	4.7	-5.2	-5.4	1.2
Singapore	5.4	9.6	6.9	-1.3	3.1	2.0
Asian NICs	7.2	8.6	6.2	-2.2	0.5	1.5
Indonesia	0.3	4.8	4.7	12.8	9.6	4.9
Thailand	4.2	4.9	4.8	-2.6	2.4	3.2
Malaysia	5.8	8.8	7.1	-0.2	1.2	1.6
Philippines	3.3	4.0	3.5	8.3	6.7	5.9
Vietnam	4.8	6.6	7.2	5.7	3.0	4.8
Five ASEAN Countries	3.1	5.5	5.1	4.8	5.2	4.0
China	7.1	8.1	8.0	-2.6	-0.1	1.1
Ten Asian Economies	6.4	7.8	6.8	-1.1	1.1	1.8

Notes:

1. The figures for 1999 are actual and those for 2000 and 2001 are forecast.

2. The Asian NICs are composed of South Korea, Taiwan, Hong Kong and Singapore, the Five ASEAN countries consist of Indonesia, Thailand, Malaysia, the Philippines, and Vietnam, and the Ten Asian Economies are composed of these two groups, and China.

3. The GDP growth and inflation rates of groups such as NICs are based on a weighted average of those corresponding economies based on the 1999 GDP (US dollar denominated). The composition ratio of the various countries and regions is as follows: South Korea 17.1%, Taiwan 12.1%, Hong Kong 6.7%, Singapore 3.6% (a total of 39.5% for the NICs), Indonesia 6.0%, Thailand 5.2%, Malaysia 3.3%, the Philippines 3.2%, Vietnam 1.2% (a total of 18.9% for the ASEAN 5), and China 41.7%.

THE ASSOCIATION OF BUSINESS EXECUTIVES

ADVANCED DIPLOMA – BUSINESS ADMINISTRATION

CSBP

Case Study in Business Policy

afternoon 5 June 2001

1 Time allowed: **3 hours**.

2 Answer **ALL** questions.

3 All questions carry different marks. Note the mark allocation and budget your time accordingly.

4 Calculators are allowed.

5 This is an open book examination and you may consult any previously prepared written material or texts during the examination. You must **not** insert such material into your answer book. Only answers that are **written during the examination** on paper supplied by the examination centre will be marked**.**

6 Candidates who break ABE regulations, or commit any malpractice, will be disqualified from the examinations.

Answer ALL questions

Case Study – Redland and Lafarge

Q1 Evaluate Lafarge's strategy prior to the take-over of Redland in 1997. (40 marks)

Q2 Discuss the rationale behind Lafarge's acquisition of Redland and comment on the management of the acquisition, paying particular attention to factors of strategy, structure and synergy. (35 marks)

Q3 Using an appropriate framework, formulate a strategy for developing Lafarge's cement business in the Asian region. (25 marks)

Advanced Diploma in Business Administration

Case Study

Examiner's Suggested Answers

Question 1

For a comprehensive strategic analysis, students will need to address the issues of:

- Mission
- Goals and objectives
- Industry and general environment(s)
- Lafarge's rationale for choice of acquisitions
- The overall strategy and planning and the resulting trend in performance using basic financial performance indicators.

Mission
The mission statement sets the framework and the culture within which a company intends to operate. From this flows the objectives of the company and subsequently the benchmarks by which it may measure its performance

For example:

The Role of the Mission Statement

- Provides a visible sense of purpose
- Provides an image
- Specifies the aspirations of the organisation.

The mission statement captures the culture, values and ethics of the organisation and makes a declaration of its attitude and outlook.

Comments
Chairman Bertrand Collomb's remarks (pp 2/3 of the case) provide some insight into these missionary aspects and we can pick up various phrases which relate to direction and aspirations: *"leadership positions in our businesses …greater professionalism and industrial excellence …losing sight of our respect for people …for employees and customers, end uncertainty and respond to expectations rapidly… respect for our people and our cultures"* and so on. These internal/external foci suggest a well thought out mission.

Objectives
We can again, make some general statement:

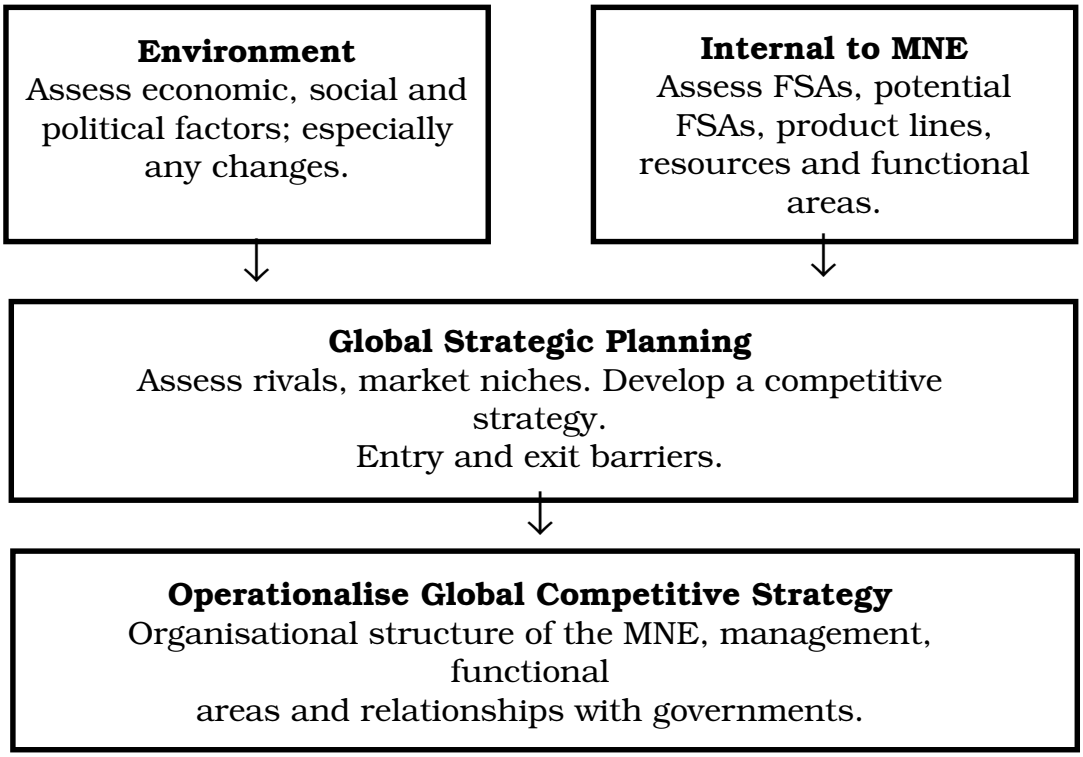
Business Objectives

- Should be clear and explicit
- Should be achievable
- Should be measurable
- Should be communicated to the appropriate people.

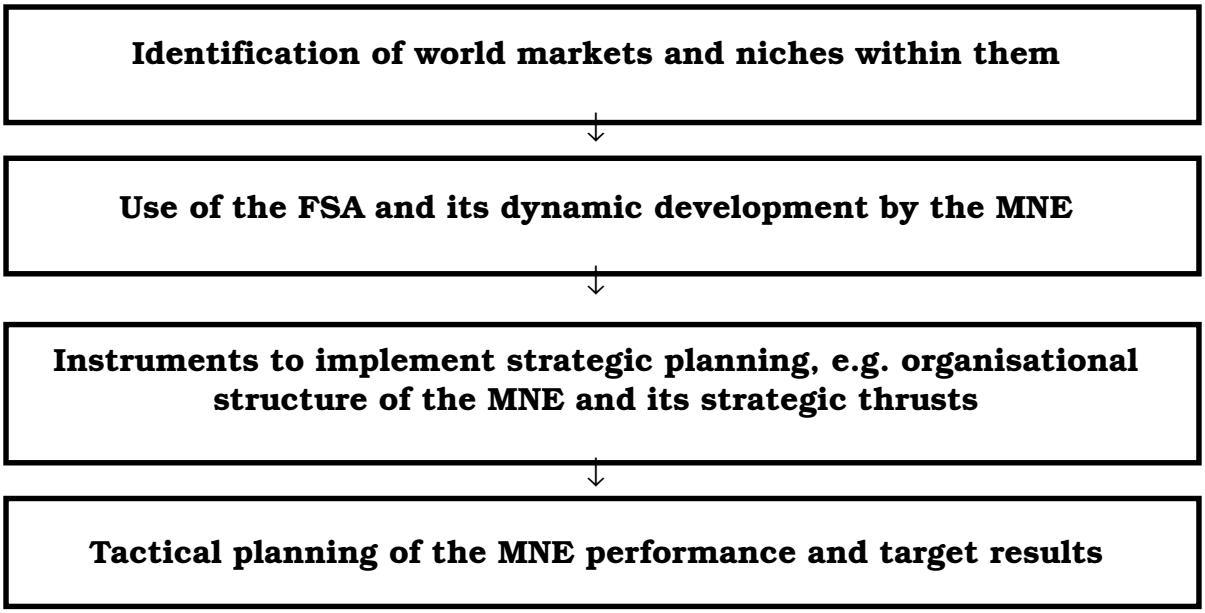
One gets the impression that Lafarge is professional enough to meet these criteria but there is no precise evidence in the case to support 'measurability' of objectives. On the other hand, precise objectives tend to be confidential or communicated on a need-to-know basis, so perhaps we shouldn't be too surprised.

We do however, have statements in the case relating to *"competitive… profitable… balance of portfolio… leadership… create value…* and of course… *growth".*

The more industrious students might adopt the international perspective/'model' approach such as the following:



OR



Here strategy is influenced by:
- Environment itself
- Government induced changes in the environment
- Firm must respond to changes in government regulations over time
- This may affect firm specific advantages (FSAs) and capacity to exploit these in the world
- To maximise value profits goal is to develop, produce and gain world markets for product lines which make best use of FSAs.

FSA can arise in areas of:
- Proprietary knowledge
- Technology
- Marketing skills.

Here, Lafarge's expansion could be seen in the context of (taking model 1) its objectives, environment, FSA's, structure and relationship with governments etc. How FSA can be judged is not straightforward although Lafarge's emphasis on R and D might lead us to believe it is technological as reflected both in process and in product development/innovation.

Environment
The information in the case is somewhat limited but we can note the following:

1995/96 represented a very active period with the following industry changes:
- Growing demand in Indonesia
- Growing markets in Malaysia and Thailand
- Slump in German market
- Japanese market hit
- Raw material price increase.

In 1997 Europe was showing signs of an upturn in the construction industry apart from the market in Germany.

The case also notes:
- Recovery in Canada and growth in the US
- Growth in Central and Eastern Europe
- New markets in Turkey, Brazil and Venezuela
- Cement prices up
- US construction industry healthy
- Business in Asia not affected by crisis
- Public spending in Europe strictly controlled.

Performance
The company holds world leadership positions in aggregates and concrete tiles, world number 2 in concrete and European number 2 in clay tiles. However, the company stresses that competitive and profitable positioning rather than size, is the main objective. (Students might question whether indeed there is an essential relationship here, e.g. *cost leadership.*) We might also assume shareholder confidence, strong management, efficient procedures and a strong R and D led product development and improvement programme.

From Table 2 appended, the company appears to have ridden the waves quite well. Although return on assets (note assets are 'total') is diminishing, share price shows signs of recovery; however, the share has not performed well against the Bourse index over the same period and this may be a function of the declining margin and profitability returns.

Capital gearing is high although not surprising for an acquisitive company; we don't know whether Redland's purchase is accounted for in the balance sheet although it is unlikely given that the purchase occurred at the end of 1997.

Question 2

There are two broad reasons put forward in favour of acquisitions:

- The first is that there is some *Industrial logic* behind the move. It is argued that by combining companies it can improve their competitive position through synergy and/or economies of scale. Or the need to be larger to meet global competition.

- The second argument is based on *Managerial* or *Competitive* grounds. This argument which is deployed in support of hostile takeover bids is that it is an opportunity to remove poor management, demonstrated by the weak position of the company, and to replace it by good managers as demonstrated by the ability to make the hostile bid.

(In fact, although there is an element of truth in this view in that poor management does often make a company vulnerable to a hostile takeover, it is also the case that there can be many other reasons which can put a company into such a vulnerable position.)

In target selection some general principles should apply:

- The industry should be *structurally attractive*
- The cost of the acquisition should not leave the company worse off in earnings per share terms
- The Porter '*better off*' test suggests that skills or benefits must be shareable between the two companies
- The strategy should have some basic criteria: Pricing, Timing, Method of Payment.

In integrating the victim the acquirer would normally:

- Apply new financial controls by implementing its own systems
- Review HQ and overhead costs and see what can be cut out as you will not need two HQs
- Review the senior managers and see who can be kept
- Review the capital investment programme and see if it fits into the overall strategy.

From the case we note that the strengthening of *competitive position* and a better *balanced portfolio* are two of the main motives for the acquisition, along with the

transfer of assets to more effective management.

It is clear that Lafarge are approaching the integration seriously, in a systematic fashion and going for quick improvements in Redland's businesses operating income. Also, we note the attention to consolidating *financial data* and *work procedures* and this might mean there is little intention of letting the Redland side continue as an identifiable, autonomous unit, say, in the medium- to long-term.

Almost certainly, the acquisition should benefit from synergy gains in most areas including those which are financial, marketing and technology related. Economies of scale in certain business areas should be achievable, savings on marketing and transfer of management skills. However, the issue of Redland's joint ventures remains an issue for speculation. Would these have been transferred to Lafarge as they stand and if so, do they fit Lafarge's strategy/structure profile? We might question this, given the company is used to growth through outright acquisition and tight integration of the 'victim'.

We really need more information before making any further assumptions but on the whole, Lafarge appear to be managing the acquisition 'by the book'. Perhaps it is what is 'between the lines' which makes the analysis interesting and contentious. One might conclude that all will not be plain sailing. Certainly, the 1998 figures will be something to watch out for!

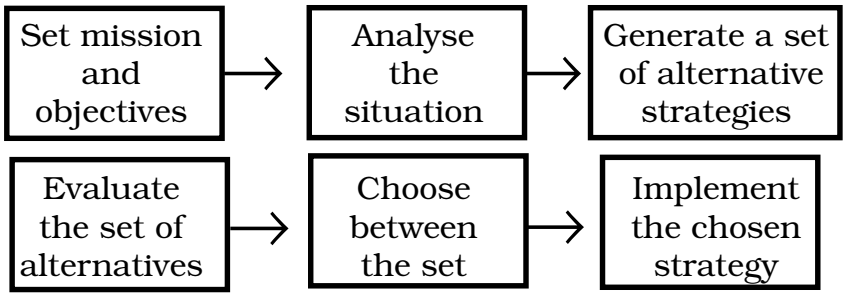
Question 3

Students should appreciate the need to assess Lafarge's position in the global industry and to have at least *a basic structure* for identifying and evaluating the alternatives open to the company.

For example, 'SWOT' can provide a means of a broad, qualitative analysis while 'sustainable growth' is one quantitative means of assessing the company's potential for capitalising on the opportunities identified.

Strategy formulation is a complex process (see figure below) that is based upon the needs and wants of the stakeholders and upon an estimate of the company position. It requires the addressing of possible alternatives based on the key strengths of the company and the realistic alternatives available to it. The ultimate choice and implementation thus largely rests on the quality of the situational analysis and the evaluation of alternatives.

Strategy Formulation



Students should use their previous analysis to develop a situational analysis/

'SWOT' table from which the various alternative strategies can be identified and evaluated. However, in this case we are only concerned with Asia so our 'alternatives' are limited to markets.

Each possible course of action should be evaluated on the basis of the objectives to be achieved and a choice made according to the relative returns to the company.

Use should be made of the industry data given in the case, although its datedness and limitations should be acknowledged. In examining the feasibility of alternatives reference to Lafarge's mission, objectives and preferred strategies should be seen as paramount. In this respect, there are several pointers from the case (as noted in Question 1 above) such as:

- "improving the balance of our portfolio"
- "reducing exposure to geographical risks"
- "leadership positions (strengthening)"
- "creating value (for shareholders?)"
- "further improve service to customers".

We note that the planning horizon is five years and that the previous plan was based on "creating value from current operations, expanding all businesses geographically and broadening the range of products" (p3).

Strengths

Looking at Lafarge's performance in Table 2 attached, the company appears to have ridden the waves quite well. Although return on assets (note these are 'total') is diminishing, share price is increasing as is total assets per share (*shareholder value*). In general, there is little to suggest anything other than satisfactory performance.

The company holds world leadership positions in aggregates and concrete tiles; world number 2 in concrete and European number 2 in clay tiles. However, the company stresses that competitive and profitable positioning rather than size, is the main objective. (Students might question whether indeed there is an essential relationship here, eg. *cost leadership*.) We might also assume shareholder confidence, strong management, efficient procedures and a strong R and D led product development and improvement programme.

Additionally, the company has a strong international presence.

To summarise, the strengths are:

- Financial performance
- Effective planning systems
- Good management
- Shareholder confidence
- Industry leaders
- International presence
- R and D.

Weaknesses

- Share price is recovering but not back to its 1993 level
- Capital gearing is on the high side and this must affect the group's borrowing capacity.

Opportunities and Threats

The eventual choice must trade-off risks and returns and the company should be attempting to maximise opportunities whilst minimising threats. With respect to Asia we note several forecast developments from *Appendix 7* of the case which include:

- In 2001, continuation of Japan's economic recovery
- China, Hong Kong, and Malaysia economic expansions
- Indonesia will suffer adverse effects of continuing political instability and will see an economic upturn
- Deceleration of economic growth rates of South Korea, Taiwan, and Singapore
- Vietnam to experience a growth rate of 7.2% and foreign direct investment start picking up
- Philippines' economic growth rate decline and political situation to remain unstable.

More specifically from Table 1 of the note, we can isolate the following as possible opportunities:

	GDP Growth (in real terms)			**Inflation Rates**		
	1999	**2000**	**2001**	**1999**	**2000**	**2001**
South Korea	10.7	9.3	6.7	-1.6	2.5	2.3
Malaysia	5.8	8.8	7.1	-0.2	1.2	1.6
Vietnam	4.8	6.6	7.2	5.7	3.0	4.8
China	7.1	8.1	8.0	-2.6	-0.1	1.1

Furthermore, we are informed from *appendix 6* that cement was one of the top three industries for mergers and acquisitions in Asia in 1997/8. Also from *Appendix 3*, we note that through Redland, the group has roof tile interests in China, Indonesia, Thailand, Japan and Malaysia and Singapore.

Malaysia and China are looking like areas for potential expansion, although China is seen as unattractive *(Appendix 6)* by some analysts. Thus, Malaysia may be the best prospect initially.

Evaluation

Firstly, we need to think about Lafarge's mission and objectives and particularly those relating to risk, growth and shareholder value. With regards to the latter, the current capital gearing is a problem, say, for acquisition strategy, particularly if the Redland purchase has not been accounted for in the 1997 balance

sheet. However, we don't even know if any potential cement acquisitions would take the group into the market under consideration.

The company has strengths in R and D, acquisition management, a 'multicultural' structure orientation, and a presence in Malaysia. It has, however, to combat competition from the other major groups, so it will probably not be an easy ride.

Table 2

LAFARGE ASIA ANALYSIS	1997	1996	1995	1994	1993
1. Sales	42,066	35,262	33,218	89,910	82,241
2. Gross Operating Income	8,128	6,222	5,880	29,705	26,531
3. TOTAL ASSETS	73,731	42,555	37,535		
4. Inventories and work-in-progress	6,758	4,088	3,828		
Accounts and notes receivable, trade	9,968	6,897	6,555		
Other receivables	4,104	1,843	1,719		
Accounts and notes payable, trade	-5,480	-3,542	-3,353		
Other payables	-10,645	-5,138	-5,074		
Total equity	35,066	29,613	30,749		
Provisions	6,391	3,625	3,803		
Long- and medium-term debt	33,012	10,637	6,436		
Attributable net income for the year/share	27.2	20.5	26.6	25.9	
End of year share price (FRF)	394.9	311.3	315.5	380	466.6
SBF (French Stock Exchange) 250 Index (1982=100)	800	650	530	535	600
ANALYSIS					
Profit Margin	11.0	14.6	15.7		
% ROCE	9.0	12.1	12.8		
% Gearing	112.4	48.2	33.3		
% EPS growth	32.7	-22.9	2.7		
P/E Ratio	14.5	15.2	11.9		
Stock Turnover (times per year)	5.0	7.1	7.1		
Current Ratio	1.3	1.5	1.4		
Acid Test	0.48	0.34	0.30		
SBF index % growth (based to 1993 figure)	33.3	-8.3	-11.7	-10.8	0
Lafarge % share price growth (based to 1993 price)	-15.4	-33.3	-32.4	-18.6	0