Qualitative factors influencing the potential success of New Zealand firms at internationalising

By Duncan Chadwick[1]

Abstract

This research, completed on behalf of New Zealand Trade and Enterprise, was an initial foray into investigating the qualitative factors that influenced the success of New Zealand firms at internationalising. The project produced five case studies of different firms and their successful efforts breaking in to international markets. Four factors were found to be fairly common across the firms surveyed. These were: access to external equity capital; board governance processes; a management team that optimised the firms resources (including placing key personnel overseas); and a willingness to engage in market-led innovation (once the initial technology had broken into the market). The project size meant that the sample of firms was not representative of the population of firms across industries and by size, but provides avenues for further attention.

Introduction

The research that forms the backbone of this paper was carried out on behalf of New Zealand Trade and Enterprise (NZTE), who were seeking selected interview-based case studies of successful exporting firms, which focussed on understanding what these firms believed were the main contributors to their success. These contributors included, but were not limited to:

- management and governance
- smart processes and systems
- innovations
- individual leadership
- market changes creating opportunities

The case studies focussed on the key contributors to success offshore, the lessons learned from experience and highlighted some of the practices adopted by these firms offshore.

Methodology

The methodology used to develop this research was simple and based upon the requirements of NZTE for detailed case studies of five firms that have succeeded at internationalisation. The speed required for the delivery of the initial research project dictated the research design to a large degree. The other factor influencing choice of methodology was NZTE's requirement for looking at qualitative contributors to the successful internationalisation of New Zealand firms, as identified above. The five firms selected for inclusion were drawn from a pool of 15 firms identified as having documented international activities, but not widely known outside of their respective industries. These firms were willing to accommodate the short time frames necessary to complete the research. Given the small sample size, some representation across industries and for firms at different points in the internationalisation process was attempted, but was a secondary consideration to the two main research criteria listed above.

Case Study Results

A summary of some key information about the internationalisation profile for each company participating in the research project is provided in the Table 1.

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Table 1 – Summary information for firms participating in the research

	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5
Founding Year	2002	1998	2001	2000	1998
First year of export	2002	2002	2001	2003	2006/07
Main Markets	US	Europe	US and Europe	Australia and Asia	Japan
Turnover	$20m-$50m	$20m	$20-50m	$5m-$10m	<$5m
Exports %	99%	90%	99%	60%	1%
Staff	50	67	100+	35	20

Commonalities across the internationalisation experiences of the surveyed firms infer that their keys to success include:

- Knowing and operating within a well-defined niche.
- Picking the part of global value chains that provides the best fit with the firms' strategies and resources.
- Utilising market-led innovation and R&D to satisfy customer needs.
- Having the right people in the right place at the right time, especially in offshore markets, is fundamental.
- Control of some or all of the manufacturing process helps to promote quality, mitigate delivery risk, protect valuable IP and allow greater control prior to scaling up production through offshore contract manufacturing.
- Applying systems and processes is kept to where they are most important; otherwise many of these firms would run the risk of stifling growth.

Over the five firms used as case studies for this project, the following four factors stood out as key differences in the process of internationalisation:

- The role and composition of the board in terms of the skills, networks and experience brought to bear on the internationalisation problem.
- Management team development as an integral part of internationalisation.
- Access to outside capital to fund growth in international markets.
- Choice of business model dictating the speed and concentration on firm internationalisation.

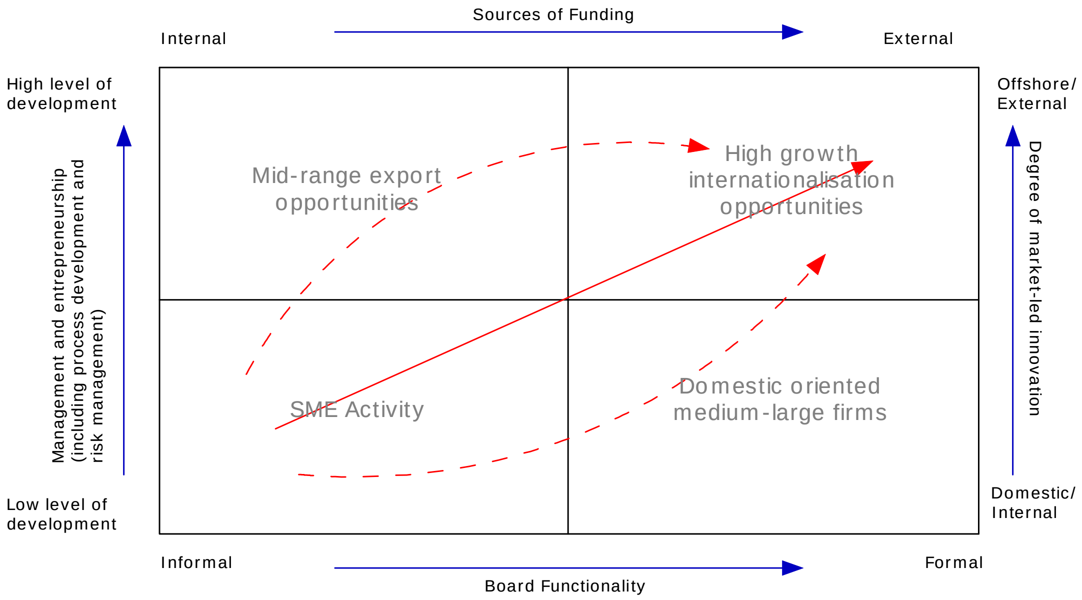
Based on the findings from the interview process, the requirements to successfully establish a firm on international markets can be broadly summarised in the following factors:

- Board functionality, in terms of monitoring management performance, strategy setting, and bringing valuable business and social networks.
- Access to external sources of funding to scale the firm towards internationalisation.
- Management leadership and entrepreneurship that identifies markets and makes the most efficient and effective use of the firm's resources. This includes resource distribution and allocation between local and international markets.

- The degree to which innovation and R&D are led by the market, especially offshore markets. The capacity to transcend the original product / technology development to continuously meet market expectations is an important contributor to internationalisation.

The above issues have been developed into a broad model to analyse internationalisation, as illustrated in Figure 1, which integrates the features and aspects of the main contributors to successful internationalisation, highlighting different business models in the process.

Figure 1 – Four broad factors impacting upon successful firm internationalisation



Note that the model makes no reference to turnover but concentrates on the relative development of the four attributes described above as markers for successful and sustained internationalisation. The red solid line denotes the more direct path taken by the most successful firms at internationalisation. They are able to simultaneously pull together the sets of resources and actions necessary to move into a high-growth opportunity space. The dotted red lines meantime, track a more roundabout, or incremental, approach to internationalisation. The paths shown represent the different business models employed by the firms.

A reflection of the choice of companies that participated in the interview process was the dichotomy between the more 'traditional' models of exporting goods from New Zealand and the 'modern' global business models deployed in the different industries. Previous survey reports, such as Castalia (2007) and Sweet and Nash (2007), have found supporting evidence around the diversity of models employed. In the literature, Scott-Kennel (2008, page 5) classifies the differing approaches as either 'traditional', with an incremental approach to internationalisation, or 'accelerated' model that leap-frogs many stages in the traditional approach.

The differences between the approaches, as applied to the SME companies interviewed, are reflected in the following points:

- Firms adopting the global business model seem to have found the balance between the emphases on the product and focussing on marketing based upon customers' needs. Traditional models have more of product orientation looking for a market, something the global models have transcended.
- Global business model firms retain their customer interface, whereas the traditional model loses some or all of the relationship with the end-user of the product.
- The traditional model sits upstream from the end user by choosing to control product manufacturing and relies upon existing distribution channels to market to the final consumer and, to some extent, for market intelligence.

- The global business model places a premium on the end of the supply chain relationship with the customer and then partners upstream to control manufacturing and distribution, gaining first-hand intelligence in the process.
- Firms with global business models are more likely to make the commitment to employ and locate staff in their main overseas markets. This is not only important from a customer relationship perspective, but also as a means of gaining market intelligence.

The power in the different models can be seen through the control over access to the end customer and therefore which model has more control over the marketing functions (including product pricing). On the surface, this seems to have translated into better access to outside capital (in conjunction with the presence of a proper governance structure), more access to skilled individuals and their networks and ultimately faster growth.

Board functionality

Board structures differ between the firms interviewed, in that while all firms had some form of board structure in place, they varied in formality and whether independent directors were present. In the end these differences can have a large impact upon the rate of growth a firm experiences as a part of the process of internationalisation. Table 2 highlights these differences.

Table 2 – Differences in board composition and role

Board characteristic	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5
Degree of board formality	✓✓✓	✓✓✓	✓✓✓	✓	✓✓
Independent directors	✓✓	✓✓	✓✓✓	✓	✓
Management monitoring	✓✓✓	✓✓✓	✓✓✓	✓	✓✓✓
Mix of skills	✓✓	✓✓✓	✓✓✓	✓	✓✓
Board networks	✓✓	✓✓✓	✓✓✓	✓	✓✓
Listed company	No	No	Yes	No	No
Outside funding present	Yes	Yes	Yes	No	Yes

Note – the ticks in the table indicate the relative strength of each characteristic, with 3 ticks representing a strong factor, 2 ticks a moderate factor and 1 tick a weak factor.

The roles that the various boards play also differ based upon their composition along the following lines:

- Skill sets and networks – the firms surveyed with more formal boards (2 ticks and above) tended to have directors with a mix of skills and networks that facilitated the solving of problems related to international expansion.
- Monitoring – The degree of management monitoring across the companies was fairly consistent, with reporting structures set up by the boards requiring the regular generation of board papers by management reporting on progress against strategy targets.
- Strategy – The degree of involvement in strategy setting varies in intensity between the board operations with some boards having a regulatory requirement to actively set strategy two years out. A common feature across the interviews was boards working with management to set and deliver strategy.

Companies that had more formal structures in place and delineation between management and governance seemed to have access to capital for expansion and the option of being able to tap the social and business networks of both directors and senior staff.

Management team development

How the management team develops and the division of responsibilities between members of the team makes a significant impact upon the speed and penetration of firms into international markets. There are four factors that influence the capability of the management team:

- Specialisation and structure – responsibilities are divided between specialists in their respective fields, such as finance, sales and marketing and technical disciplines. The most successful have all invested heavily in team development, with an emphasis on the right people in the right places at the right time. Division of responsibilities is also along specialist lines, with highly experienced and networked staff recruited to fill these roles.
- The location of the team members in relation to head office. The most successful have the key sales and marketing functions located in their main offshore markets, as a conscious decision to be close to customers.
- Decision-making within the team – the more successful teams had delegated decision-making with defined limits in place, enabling those members located in offshore markets to operate with a degree of day-to-day independence.
- Optimising the use of the firm's resources. This is one area where all firms, regardless of management structure, are actively focussed to ensure that best value is achieved.

The interview outcomes highlighted the differences between firms in terms of whether firms developed their international markets quickly or whether a more cautious and incremental approach was taken. All firms exhibited high degrees of entrepreneurship along the lines suggested by Bhowmick (2008) – in terms of effectively using the resources currently at their disposal in the most efficient manner possible. There were degrees of difference between the companies – some had the role developed to a high degree, while the others were some way behind in terms of development.

Access to capital to fund growth

Firms also differed in how their operations attracted capital to fund expansion, as shown in Table 3. The literature in general, including Scott-Kennel's (2008) survey of previous papers covering access to capital by private firms, suggests access to adequate amounts of equity capital on good terms is a barrier to SME growth and internationalisation. Some of this, as Scott-Kennel suggests, is due to the owner-managers of firms wishing to maintain their independence, while the ANZ (2008) research indicates a preference for traditional bank credit lines to fund business expansion.

The majority of firms participating in this research, bar one, have successfully found outside investment to fund both business development and internationalisation.

- This is against the accepted findings in the literature.
- Most firms that have attracted external equity funding have found it through additions to boards, angel investment as first round, private equity rounds and, in the case of Endace, an IPO.
- Possible reasons suggested for the diversion from the norm include scalable product for international markets, a sound business model and governance structures in place to give investor confidence in management.

It should be noted however that one possible reason for diversion from the conventional wisdom could possibly be self-selection bias, in that this project was tasked to look at firms successfully internationalising. Given Robertson's (2006) assertion that only 6% of firms were looking for outside equity investment in 2004 and that this is a typical range on an international scale, then this research may have had a lucky run with finding firms in the 6% bracket.

Table 3 – funding profiles for the firms interviewed

Source	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5
Founders / Shareholders	✓	✓	✓	✓	✓
Angel Investment	✓	×	×	×	×
Private equity	✓	✓	×	×	×
Venture capital	×	×	×	×	×
Listing (via IPO)	×	×	✓	×	×
Organic via profit earned	✓	✓	✓	✓	✓
Rounds of funding	3	2 and ongoing	1	0	1
Sales	$20-$50m	$20m	US$24m	$5m-$10m	<$5m

The capacity to tap external funding sources is an enabler for speeding up the internationalisation process. The table indicates that those firms which have successfully sought outside funding have grown faster in a short space of time than those that have relied upon current founding shareholder funding and retained earnings. Based upon the interview outcomes, the attraction of funding into a firm to support internationalisation seems to respond to:

- The presence of formalised board structures to monitor the performance of the firm.
- The adaptability and scalability of the firm's product to meet international market requirements.
- The scalability of the business model employed by the firm to provide reach into overseas markets.

An observation that arose during the course of the interviews related to the under-investment in New Zealand companies and the over-reliance on retained earnings to fund growth. Some managers thought that there was too much emphasis placed on a firm becoming profitable rather than pursuing growth as a business strategy. It was implied that this may have longer-term consequences upon the value capable of being generated by New Zealand firms and for their capacity to survive in international markets.

Degree of market-led innovation

All firms surveyed followed some degree of innovating based upon soundings taken in the market place. The differences in the firms arise because of the weight given to systematising the process and embedding it into the firm's culture. Those that were most successful were able to accomplish three things:

- The ability to transcend the original product / idea development and push on to a wider array of customer requirements.
- They have systems in place to receive market feedback. This includes having in-market resources interfacing directly with customers.

- The capacity to undertake the adaptation of the product and technology base to meet the market.

Direct communication with customers as end users was vital for the continued innovation of product lines and for targeting scarce research and development resources to work on the most pressing problems. The more successful firms integrated their research and development activities into their marketing, with customer visits by technical personnel being very important. Of the literature reviewed, including Scott-Kennel (2008) and Drucker (1986), the need to be innovative to maintain a competitive advantage is at the forefront of firms' strategies. However, the literature also suggests that organisations need to be careful with innovation in foreign markets in order to protect their intellectual property and their future revenue generating potential.

All firms interviewed practised continuous innovation across their product range, but with an emphasis on market-led innovation based around customer requirements. The linkage between innovation and marketing is not outlined in the literature reviewed (other than Drucker, who alludes to it) to the same extent as it became apparent when undertaking our interviews. What was also apparent were the lengths taken to protect the IP within firms' product offering, through a combination of legal measures and control of the product development and manufacturing process.

Conclusions and further research

This research started off with the premise that there are a number of potential factors that influence the success of firms as they go through the process of internationalisation. Castalia (2007) find that there is no one particular "uber-model" that can be fitted to describe a generalised case of internationalisation for New Zealand firms. The findings of this rather small piece of research point towards agreement with Castalia's assertion.

It would appear however from this work that the companies who think of themselves as global businesses based in New Zealand, rather than as New Zealand exporters of physical goods and services have an advantage. Whether this is solely in the mind-set and mental models adopted by these firms as part of this business model or whether it a systemic feature of the model is unknown.

Looking at what gave these firms the advantage, four main factors were identified as contributors to the success of firms' efforts to internationalise:

- Board functionality, in terms of monitoring management performance, strategy setting, and bringing valuable business and social networks.
- Access to external sources of funding to scale the firm towards internationalisation.
- Management leadership and entrepreneurship that identifies markets and makes the most efficient and effective use of the firm's resources.
- Resource distribution, particularly the sales and marketing functions, between local and international markets. This seems to be an important issue for converting the earlier development of proprietary technology into market-led innovation.

Based upon the broad conclusions drawn, further directed research along the following lines could be warranted:

- Management and governance issues around the strategic choice of where the firm locates in the supply chain and the potential costs associated with moving a firm to a different position after the initial choice.
- Innovation and R&D, particularly as these functions are mapped to marketing on an operational basis.
- Leadership and entrepreneurship as it pertains to creating the monitoring and control frameworks for establishing sales and marketing functions in offshore markets.

Again, it should be stressed that this is only a small project so it is difficult to draw inferences from a sample size of five firms, especially when the firms were selected for availability rather than through a process ensuring balance and wider industry representation. The opportunity for further research with more meaningful and representative sample sizes is therefore apparent.

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