Deliverable D3.2.1
FUNDEMENTAL ELEMENTS OF INTERNATIONALISATION STRATEGY
Training Programs Document

CONTENTS

CONTENTS 2
1. FUNDAMENTAL ELEMENTS OF INTERNATIONALISATION FOR CLUSTERS 3
1.1 THE NEED FOR A STRATEGY 3
2. FOREIGN MARKET ENTRY MODES 3
2.1 Exporting 4
2.2 Turnkey projects 4
2.3 Licensing 4
2.4 Franchising 5
2.5 Joint Ventures 5
2.6 Wholly Owned Subsidiaries 5
3. INTERNATIONAL MARKETING STRATEGY 5
4. CONCLUSIONS 6

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1. FUNDAMENTAL ELEMENTS OF INTERNATIONALISATION FOR CLUSTERS

This training document is based on the deliverable D3.1 (Inventory of ESCP's and Clusters' internationalization methodologies and tools) and is designed to assist Clusters in identifying what they have to consider and have to do to prepare strategies to go international with their member companies.

1.1 THE NEED FOR A STRATEGY

It is inappropriate to approach the internationalisation process without formulating a strategy; a plan of action that is formulated and carried out to achieve a particular goal. Formulating a strategy involves deciding when, how and which markets cluster members want to enter. There are several market entry modes you can choose from; such as export, joint venture etc. The internationalisation process involves risk and uncertainty and they significantly impact upon any strategy. In order to internationalise successfully, clusters should consider how to lower the risks and uncertainty for member companies; they can do so by choosing the right strategy and methods based on the capabilities and preferences of member companies. In order to go international, cluster management teams have to plan for the process to happen. Market knowledge is a key element of a good strategy and method for internationalisation.

There are also some other important factors such as: business network, previous experience and skills of the management team, role of the owner- manager, financial resources, government agencies, age and size of the cluster member companies, entrepreneurial abilities and services etc. While planning to internationalise, the cluster manager should advise the member companies on the pace and timing of the process as well as the entry mode to use. The following section details different entry modes: exporting, licensing, franchising, turnkey projects, joint ventures and wholly owned subsidiaries. Each one of the entry modes would apply to SMEs depending on their knowledge, competitive advantages, market commitment, governmental issues, financial resources, age and size of the SME, etc

2. FOREIGN MARKET ENTRY MODES

There are three basic entry decisions that cluster manager has to consider before going international (Hill, 2007):

1. Which market: the one being more attractive to the SME, seeking a balance between benefits, costs and risk.

2. When to go abroad: or timing of entry can be described either as first-mover or later entrants. First movers are those SMEs that go to an international market before anyone of his kind/industry enters a foreign market. Later entrants are those SMEs that go abroad after other SMEs have done so. Both first and later entrants have advantages and disadvantages. First movers are able to be pioneers in the market, but at the same time they can experience high costs. Whereas, later entrants can just copy first movers, avoiding risks they have already taken and having less cost on their proceeding. But, they will have more competence in the selected market.

3. The scale: a SME can enter on a large or small scale depending on the involvement of commitment they (the SME) are willing to have. Entering on a large scale implies rapid entry and involvement of significant resources. The small entry allows a SME to learn from the market chosen with less exposure to the market itself.

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After considering the three main factors mentioned above, the cluster management team should decide how to internationalise. There is no right or wrong way to go international, it all depends on the SME's size, age, resources, commitment to market and the market itself. Each of the next six entry modes have disadvantages and advantages that make the management team make their decision on how to go international.

2.1 Exporting

Exporting has been traditionally regarded as the first step to entering international markets, serving as a platform for future international expansions. It is considered to be the most used strategy for SMEs because of the lack of resources and certain degree of market knowledge and experience. One advantage for a SME that exports is that it avoids the cost of manufacturing in the host country. This might also be seen as a disadvantage if the costs of producing the goods are cheaper in the host country. The SME can gain a substantial scale economy from its global sales volume, when it is producing in the home country and exporting to the host country.

Another important advantage is that the SME will gain experience and even more knowledge from the host country. From country to country there are different laws that protect the home market. Some of them will do this by adding a tariff barrier which can make exporting more expensive.

2.2 Turnkey projects

This is a kind of project where two or more entities/SMEs are responsible for putting together plant or equipment (e.g., oil plants). This kind of market entry is used by SMEs in specific industries such as: construction, metal, petrochemical refining, chemicals and pharmaceutical. This type of entry mode is useful where foreign direct investment (FDI) is limited by the host country's government. One SME can possess the resources needed for the production but needs the technological know-how to proceed with the production. The other SME, "the contractor" is the one that handles the project for the foreign client. In other words, a turnkey project is seen as a way to export know-how to other countries. The benefits from a turnkey project are the great economic assets that the know-how offers, since they are valuable assets for the SMEs On the other hand, once the project ends, the contractor won't have a long-term interest in the foreign country. This can be seen as a disadvantage if the country proves to be a major market for the output of the process that has been exported.

2.3 Licensing

A licensing agreement is an arrangement where the licensor grants the right over intangible property to another entity for a specific period, and in return, the licensor receives a loyalty fee from the licensee (Hill, 2007). This type of agreement is common in the pharmaceutical industry, where patents, inventions and formulas are common. When a SME enters a host country they do not deal with the cost and risk of entering it. This kind of entry mode is good for SMEs that do not have the capital for production overseas. It is also used when a SME wants to enter a foreign market, but there are some government regulations that won't allow them to enter that specific market. SMEs that have an intangible property that they are not going to develop, tend to use this entry mode. The disadvantages of this kind of agreement are the scarce control over production, marketing and strategy used in the development and sale of the product. Once again, technological know-how when sold to other SMEs is taking the risk of generating competition with the other SME by providing them with the SME's competitive advantage.

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2.4 Franchising

Franchising involves longer-term commitments, whereas licensing involves a shorter term. Franchising is the right a SME acquires from another SME that allows them to do particular business activities, such as selling the good or the service, under the name of a specific SME, e.g. McDonalds. Franchising is a specialized form of license, where the franchisee agrees to follow strict rules about how to carry with the business activities: the type of service, setting of the physical space, etc. The SME selling the franchise will receive a royalty payment, which is related to the franchisee's revenues. The SME that sells the franchise avoids many of the costs and risks of opening in a host country by its self. A SME whose entry mode is franchise can build great presence all over the world in a short period of time, at a relative low cost and risk (Hill 2007, p. 492). One of the problems when using franchising is quality control: customers of Best Western Hotels, look for the same kind of attention when they go to their hotels in different parts of the world.

2.5 Joint Ventures

A joint venture is an entity formed by two or more independent SMEs working together. The SMEs agree to join together sharing revenues and costs, as well as the control of the new joint venture. The venture can be just a project or a long-term relationship. Joint ventures are often seen as a very viable business, since the companies involved can complement their skills. Typical joint ventures where two parties are involved are 50/50 ventures, though it can also be other combinations depending on the agreements of the parties involved. Such agreements are stated in contracts, which also state the role and kind of participation each SME will commit to.

The advantages are as follows: a SME benefits from local partner's knowledge of the host country's competitive conditions, culture, language, and political and business systems. Costs and risks are shared. In some countries this is the only way to entering that market. The SME can also overcome some risk by giving control of its technology to the other party involved. The main disadvantage is that this kind of relationship between two companies does not give a SME the tight control over the subsidiaries both local and international, leading to conflicts and battles over the control, if the strategies of both companies differ on the way things should be done in order to fulfil their goals.

2.6 Wholly Owned Subsidiaries

In a wholly owned subsidiary the SME owns 100 percent of the stock. There are two ways to gain internationalisation by using this entry mode. The first option is by setting up a new operation in the host country, often referred to as a Greenfield venture, or a second option is to acquire an established SME in the host country and use that SME to promote its product.

3. INTERNATIONAL MARKETING STRATEGY

- Find out if your product will travel. Many companies get occasional orders from overseas - thanks to the reach of the internet. But should you actively market your products abroad? Not every product travels well so if you plan to expand into new territories, find out if your product can be sold widely without having to be adapted.

- Research new territories. Your experience and the resources you have built up in your home country means that you're not starting from scratch. But you need to know how to leverage them appropriately - and that

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means researching new markets and thinking about issues such as logistics, order fulfilment and customer service.

- Assess the size of the market. How big is the market for your product in other countries? You'll have to see how established it is, find out how many players there are in that sector and how big the customer base could be. Are there any potential trade barriers or restrictions?

- Adapt your marketing strategy. You may have a product that can easily cross borders but your marketing strategy will have to be adapted. Local values, customs, language and currencies will all impact on your marketing plan. Look at your unique selling points and your branding. Are they right for the new markets you are targeting?

- Work with local partners. Working with affiliates, partners, distributors, licensees or agents can help you get established in a new market. Close consultation with business partners on the ground will ensure that your marketing materials have local appeal and don't include any mistakes.

- Check your prices. Pricing is not just about understanding currency differences - you need to research price levels in each new territory. Your overheads may also be higher so ensure that your prices take into account the cost of freight and transport, packaging and agent's commission.

- Adjust your media mix. The marketing channels you use will vary in each territory. In some countries, you may rely mostly on social media or online advertising. In other places, it could be printed publications.

- Learn local customs. When it comes to customer service, what works in one country may not work in another due to cultural differences, language and health and safety regulations. Levels of formality, business etiquette, the way you address them - all these are issues that could make or break your expansion plans.

- Get the timing right. Timing is everything. In some places, what you sell may be ahead of its time, in others it could be seen as outdated. Is demand for your type of product already peaking? Or is it just starting to grow?

- Visit and/or exhibit overseas. Participating in a trade mission or taking a stand at trade shows abroad is a good way of dipping your toe in the water, meeting contacts and making your first sales in a new market. It's also a chance to see what your competitors are doing.

4. CONCLUSIONS

Whilst there are various methodologies that clusters could employ, and suggest to member companies, the key conclusions from the above strategies and the research in deliverable D3.1 can be summarised as follows:

- *To strengthen the Partnership through trust building*
- *To strengthen the Partnership and create cross-sectoral opportunities*
- *To widen cooperation opportunities starting from the Partnership (hence with trusted peers)*
- *To better promote SMEs capabilities and highlight excellencies*
- *To improve the internationalization capacity*
- *To multiply business opportunities and deepen contacts*

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- *To create all pre-conditions for Partnership sustainability*
- *To strengthen SMEs engagement and to improve the impact*
- *To find new contacts and collect market data*
- *To improve the innovation capacity of the Partnership's value chains*
- *To attract more attention in the target markets highlighting the innovative capacity of the Partnership's value chains*
- *To obtain professional support for the implementation activities*
- *To better promote SMEs capabilities and highlight excellencies*
- *To better enlarge the Partnership*
- *To guarantee a consistent Partnership communication*
- *To gather and benchmark possible instruments to be used for internationalization*
- *To select SMEs to access training programs*
- *To support internal Partnership collaboration*
- *To be more ready for when abroad*
- *To multiply the internal networking and collaboration among SMEs*
- *To create further collaboration opportunities*
- *To strengthen Partnership visibility and business opportunities when abroad*
- *To better deliver the Partnership message*
- *To multiply the opportunities of visibility through third-parts initiatives*
- *To support financially SMEs for their participation in the Partnership's international missions*

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