The Strategic Approach to Internationalisation

How to build and manage multinationals across Asia.

By Gordon Perchthold

Asia is the global sweet spot for multinationals (MNCs) looking to generate revenue and, over the mid-term, sustained profits. It is in Asia's growth markets that these MNCs from developed economies believe they can chalk up stronger revenue growth, potentially outsized margins, and higher returns (after the start-up investment period) relative to what they would have obtained in their Home Country.

One such MNC is Prudential plc. Although it has been active in Asia since the 1920s, it only began to approach Asia strategically from the 1990s. It did so by not only committing its best management talent from the corporate office in its Home Country, the U.K., but also making considered investments in and adjustments to its international administrative structures. Prudential's organisational reconfiguration changed the standardised patterns of knowledge flows across the MNC, thereby increasing its probability of sustained success across Asia. Prudential Corporation Asia (PCA), its Asia subsidiary domiciled in Hong Kong, became the largest Group contributor to global revenue and profits. In fact, the old-world market of Prudential's Home Country dragged its market value down to such an extent that in 2019, the company chose to demerge. Prudential's U.K. and European business became a separately listed company, leaving Prudential to be an "Asia-led Group focused on capturing opportunities in structural growth markets".[1]

Yet, at the same time, the landscape across Asia is also littered with MNCs that have sought to chase revenue opportunities in the region, only to realise significant financial losses instead. One reason for such variations in performance among MNCs may be the ad hoc nature of their multi-country management practices. Home Country managers, reassigned or relocated to oversee the challenges of operating across multiple Host Countries, tend to draw mainly from their personal experiences. Along with their business education, such experiences would typically have been in the context of a single-market Home Country, which is quite different from the foreign multi-country context.

Internationalisation of Singaporean firms

Take Singapore, for instance. There is an imperative to address the knowledge gap between single-country and multi-country management practices. Singapore's economy is highly dependent upon international business. It serves as a hub for regional offices of foreign MNCs, which in aggregate employ a significant proportion of the local population. In addition, for Singapore's home-grown firms to scale into significant defendable businesses, they need to go beyond its shores and reach international markets. This is a national strategic priority operationalised by Enterprise Singapore, the government body responsible for growing and supporting local small and medium businesses in their internationalisation efforts.

Singapore is also a leading trading nation, with its deep harbour strategically located within the world's busiest shipping network. It continues to invest in world-class infrastructure and its people's education to better facilitate the logistics and efficient movement of cargo. However, excelling in trading as a capability is not the same as performing well at internationalisation. Engaging in trade with other nations requires companies to simply establish a relationship with an agent, who would represent them in distributing their product within a foreign country. Trading also does not require companies to continually confront the diverse cultures and business systems within foreign countries. On the other hand, internationalisation demands that Singaporean companies become immersed within the environment of their chosen foreign countries.

For Singaporean firms, internationalisation–that is, establishing sales or production operations in another country–can be quite challenging. Despite its diverse and rich Chinese, Malay, and Indian cultural heritage, Singapore's small population tends to adhere to a very narrow band of norms of behaviour learned through the centrally mandated and well-directed education, housing, and other established pathways, such as national service. The Singapore government's strategic longer-term orientation has contributed to the nation's successful economic development, creating a world-class institutional infrastructure supported by a rules-based economy that everyone follows. Such an environment is conducive to the efficient conduct of business within the microcosm of Singapore. Yet, these same strengths are challenges to overcome when establishing operations in foreign countries. This is because outside Singapore, there will be an uncomfortable diversity of individual behaviours, capabilities, and work practices combined with variations in the quality or even the existence of institutional infrastructure components, which is quite different from what companies in Singapore are used to and have taken for granted.

Four critical steps to build internationalisation capabilities

Translating the single Home Country success recipe into one for the foreign, multi-country context is a fundamental consideration when internationalising, not just for Singapore-based firms, but for firms in any country. Understanding the Host Country that is being considered as a potential location for expansion is one thing but recognising how your Home Country's characteristics have enabled your firm's success is another.

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Recognising and overcoming hubris is an integral part of appreciating where and why differences exist. As ancient China's military strategist Sun Tzu once said: "If you know neither the enemy nor yourself, you will succumb in every battle."

There are four critical steps to internationalisation:

1. Know thyself: What gives your firm the right to enter a foreign Host Country?
2. Know the Host Country: It may be attractive but is it accessible?
3. Identify which Firm-Specific Advantages (FSAs) can be transferred to the Host Country.
4. Assess whether your home operations can adapt to bi-directional pathways for knowledge transfer.

1. KNOW THYSELF

Singapore's population of about 5.7 million comprises 4 million Singapore citizens and permanent residents, and of the remaining 1.7 million people, a significant proportion forms the foreign labour force which builds and maintains the country's infrastructure, as well as supports the large number of foreign MNCs and Small and Medium Enterprises (SMEs) present. Even then, the population is insufficient for a Singaporean firm to achieve economies of scale in manufacturing to compete with countries in the region that have populations ranging from 24 million to 1.4 billion, which are also supporting their business sectors to develop technologies and manufacturing capabilities to create jobs locally. Furthermore, globalisation is getting re-architected with global value chains being shortened or collapsed as countries become increasingly reluctant to accept imported goods or services that could be produced locally at a competitive price.

In what respect, therefore, does a Singaporean firm have a comparative advantage? What gives it the right within the foreign market's competitive landscape to export to, or internationalise within the Host Country? Firms must objectively assess their FSAs to identify core competencies unique to the firm, which would differentiate the firm's product or service offerings in another country, keeping in mind that consumer preferences and the landscapes for competition, business, and regulations will differ. To what extent are each of these FSAs dependent upon your local brand resonance, long-term relationships, or infrastructures (e.g., transport, banking network), which are bound to your Home Country but difficult to leverage in the Host Country? It may help to break down your firm's local operations into the components found in the Business Model Canvas template, which is often used in design thinking initiatives, to identify where the gaps will be with respect to the Host Country.

But it is not just the product, service, or business model of the firm that needs to be assessed. The people are equally important. The members of your corporate board, top management team, and the broader organisation must also be capable of internationalising. It is one thing to visit another country; it is quite another to live in and conduct business within a foreign environment. In fact, people are the biggest obstacle to successful internationalisation–typically, they overestimate their ability to be effective in a foreign country and insist that their Home Country's ways must be followed. People-related criteria include:

- Corporate board and top management commitment to internationalisation that will be sustained beyond the tenure of the current CEO;
- Corporate board and top management commitment to the belief that internationalisation can stand the test of time when measured beyond a five-year horizon, and despite the market volatility that will likely occur during that period;
- A management team that can learn and accept that there are different approaches to undertaking business activities and yet achieve similar outcomes;
- Agreement on optimal weighting within the management team of locals and foreigners to reduce potential ethnocentric groupthink;
- Definition of the ethical positions and policies, which may vary from the accepted norms in the Home Country and how these variations would be addressed in the Host Country; and
- Management agreement on where the risks lie, and alignment on approaches to mitigate them.

If you have not addressed these topics adequately and reached a consensus on these matters with sufficient confidence, then do not internationalise until you have done so.

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2. DETERMINE THE ATTRACTIVENESS AND ACCESSIBILITY OF THE HOST COUNTRY

After your differentiated FSAs have been identified, determine which set of countries are attractive entry targets in terms of the scale of the population with the necessary per capita income to buy your product/service. At the advent of the current millennium, many MNCs were salivating at the prospect of acquiring 1.2 billion consumers in China. But many companies forgot to give serious consideration to the country's accessibility. How easy would it be for a foreign firm to outwit entrenched competitors, work through regulatory constraints, identify and engage government gatekeepers, adapt to cultural differences, implement different business practices, secure required intermediaries, resolve gaps in infrastructure, among many other internationalisation tasks? Many firms failed to start with the vital activity of researching their competitors who have already entered the target market to draw key lessons. Perhaps they would then have concluded that other countries would have been easier to access even if these were not quite as attractive when judged according to their population and/or gross domestic product.

The Topology of Distance Framework (refer to Figure 1) codifies the architecture of 'distance' considerations that facilitate comparison among multiple target Host Countries relative to your Home Country. The objective is to identify where the gaps are, which gaps must be accommodated, and determine whether the necessary adjustments can be made to the firm's business model and how it is organised.

This framework is rich and complex, meriting a separate paper in itself. But some simplified illustrations across a few of the eight dimensions of the framework can be illustrated using the example of say, an Australian firm, which produces a luxury retail food item like truffle oil, assessing China as a potential market for export or establishing a sales office. The two outer brown rings (dimensions) of the framework take into consideration the attractiveness of China's patch of earth. China, a country within Australia's broad geographic region, has 500 million status-conscious middle-class consumers (compared to Australia's entire population of only 25 million), extensively located in an identifiable set of very large urban centres.

TOPOLOGY OF DISTANCE FRAMEWORK

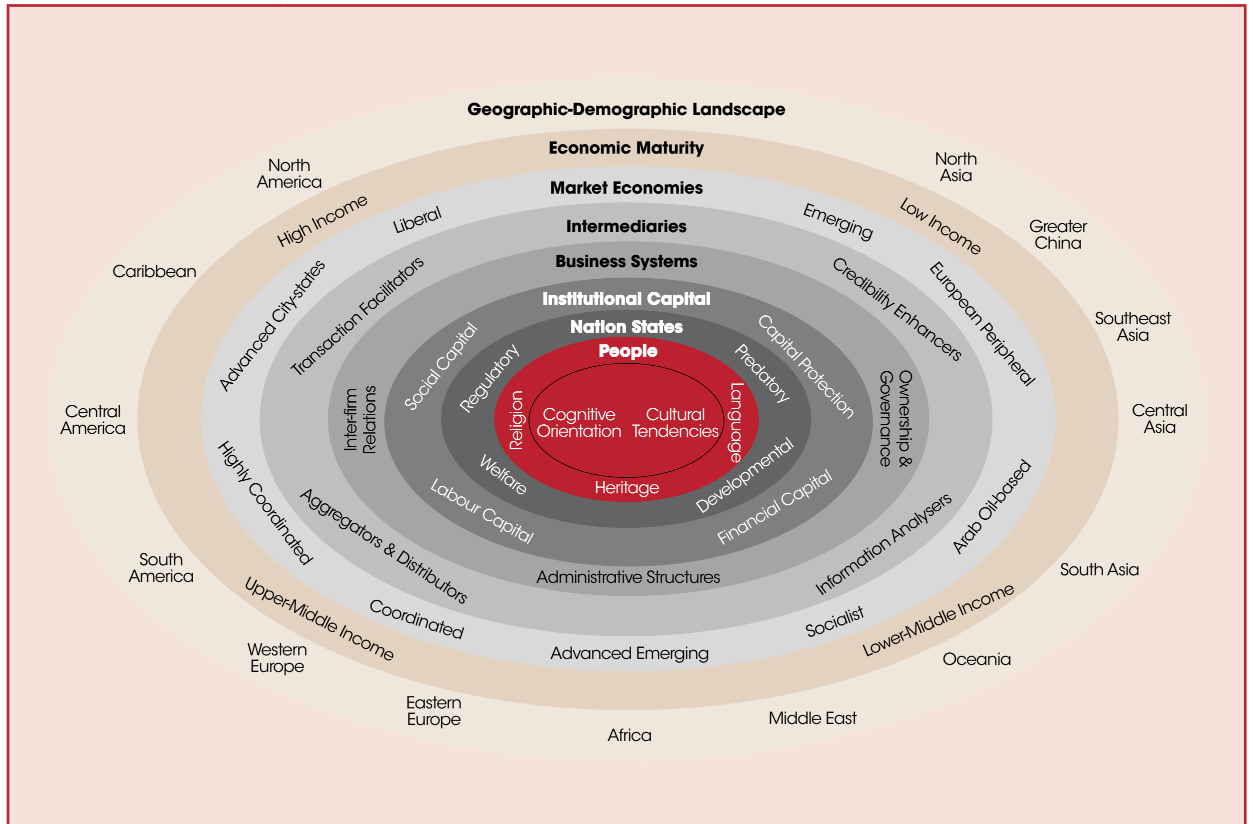

FIGURE 1 Source: Dr Gordon Perchthold, an adaptation/extension of CAGE and Comparative Capitalism Literature, 2020

But in terms of China's accessibility, let us touch on the innermost dimension—the hot core of the country (in red), which begins with the character of its People and permeates all the layers outside it. Exploring 'cognition' from the five categories for People (cognitive orientation, cultural tendencies, language, heritage, religion), academic research states that cognitive attributes do vary across countries. For example, the Australian mind focuses on the specific 'object', while the Chinese mind observes the object within its 'context', creating implications for imagery used in packaging and marketing. Another attribute is that Australians emphasise the 'individual' while Chinese emphasise the 'collective' (such as family), so the messaging around attribution of product benefits will also need to be different. There are dozens of other attributes that have implications for adjusting a firm's product proposition and positioning between Australia and China in order to more effectively access the consumer—and this is just within the People dimension.

The ability of the Australian firm's business model to access the Chinese market will also be influenced by the differences shown in the five layers depicted as shades of grey, which in aggregate contribute to the categorisation of its 'Market Economy'. The nuances among the attributes for the various categories of the five dimensions that influence the adaptions required by a firm's business model are not necessarily obvious without actually spending time within the country, or obtaining the advice of experts who have lived or worked there. For example, for the 'Nation-States' dimension, Australian firms operate within an environment categorised as 'Regulatory' that is, well-defined market conduct rules that enable the firm to advance its interests while protecting the consumer's interest. On the other hand, China has been shifting from 'Predatory' (practices that benefit the few) to 'Developmental' (increasing the well-being of the many). The Australian firm's business model and product proposition must adapt to this different social-political environment. Accessing the Chinese market is therefore not as straight-forward as in Australia. There will be unwritten protocols to navigate, such as appropriately entertaining and demonstrating respect to provincial officials who provide approvals of a firm's adherence to food standards, which may also be subject to interpretation.

> One thing is certain: the "way we do things here" mindset will have to change at the corporate office.

The foregoing provides just a taste of the breadth and depth of effort required when considering your firm's ability to access a specific country. Such effort is not immaterial, so it is important to parse and filter the analysis to identify the best few among many potentially attractive countries for market entry. It is probable that you will end up choosing to enter some countries that were not your first choice in terms of attractiveness but prove to be more readily accessible within the boundaries of adaptions acceptable to your firm. Getting the balance right is not easy, but firms with a longer-term strategic approach will build their internationalisation expertise by gaining experience as they progressively move from easier to more challenging countries to access. The Topology of Distance framework gives you a holistic architecture to explore the dimensions of differences among your Home and Host Countries.

3. IDENTIFY WHICH FSAs CAN BE TRANSFERRED TO THE HOST COUNTRY

How do you transfer the 'secret formula' of your business to a foreign market? Does the knowledge reside in the minds of a few key people? They are your bottlenecks. Relocating critical personnel for sustained periods is not always feasible, particularly as they are probably in demand in your Home Country. Has the necessary knowledge been captured (codified) in operating manuals and application systems? With complex processes, this is easier said than done, as there will inevitably be some unintended omissions or misunderstanding.

Suppose that 'secret formula' includes FSAs such as your brand positioning, physical locations (e.g., bank branches), government and supplier relationships, and reliance on an ecosystem (e.g., Silicon Valley). In that case, replicating these in a Host Country may be challenging, so mitigation strategies such as the need for a Host Country alliance may be needed to better support your market entry approach.

4. ASSESS WHETHER YOUR HOME OPERATIONS CAN ADAPT TO BI-DIRECTIONAL PATHWAYS FOR KNOWLEDGE TRANSFER

Having a strong 'how we do things here' ethos is often a hallmark of success for a firm—business practices that are commonly followed unconsciously and simply taken for granted. But when setting up operations in foreign countries, the configuration of components within the human resources administration value chain will influence the fluidity of knowledge capital flows and the adaptability of your corporate office's management practices. This configuration will be the most significant barrier to successful internationalisation.

The choices made for each of the following components will determine the extent to which knowledge of foreign markets gets transferred and absorbed by your corporate office to improve decision-making and enhance stakeholder communications, so as to manage their apprehension about and response to the inevitable volatility:

Organisation Structure

Hierarchical organisational structures that are more prevalent in larger corporations tend to convey information in a top-down direction. Information from foreign subsidiaries that do not conform to the Home Country's mode of conceptualisation typically gets rejected rather than explored further. In contrast, matrix organisations, although more complex to establish and maintain, promote a diversity of knowledge exchanges, creating broader organisational receptivity to the non-conforming data that commonly emerge from foreign markets.

Choice of Regional Leader

While diversity is generally preferable to enhance understanding and creativity, this is one instance where it is not applicable. The corporate office will already be cautious, given the perceived risks in foreign markets, as well as their practices, which may deviate from those of the Home Country. In view of the resulting volatility, the Regional Leader must have credibility and be able to command respect, which is typically possible only if his/her profile is similar to those from the corporate office–at least, until the firm has become a mature MNC. So, if the Regional Leader shares the same nationality as those in the Corporate Office, and has chalked up a reasonable tenure and successful track record, he or she can be supported by staff with knowledge of the foreign market.

Leadership Development

The most successful MNCs break the ethnocentric cycle of a new expatriate from the Home Country being posted to key roles in the Host Country every three to five years. Rather, successful MNCs identify and move talent of various nationalities to positions of increasing responsibility in different countries over the course of their careers.

Criteria for Promotion

Attaining a position in the top management team can be competitive and political. The 'out-of-sight, out-of-mind' syndrome can discourage talented Home Country managers from taking a foreign posting for fear that it could slow down their advancement. The most successful MNCs break this ethnocentric orientation by making international experience a precondition to entering the C-suite.

Decision-making Processes

Relevant expertise should be tapped for any decision. Accordingly, participants in decision-making on international operations issues should extend beyond the corporate office to include those in the relevant regional office and country subsidiaries. A top-down decision-making approach will overlook essential information to the detriment of the MNC.

Internal Communications Patterns

Knowledge flows need to become multi-directional, rather than follow a simple top-down, hub-and-spoke path in order to benefit from shared experiences and recognise the diversity of business approaches that could be applicable across markets. Knowledge will resonate more with Host Country personnel when they participate in the conversation, discover its value, and apply the knowledge in their context. At the same time, the process will allow Home Country management to become better informed about the realities in the Host Countries.

Codification of Business Processes

The standard approach for new initiatives is for the corporate office to define the process, then communicate it to the subsidiaries for their implementation, applying a delta from standard where necessary. This approach fails more often than not and rarely results in enthusiastic buy-in from the subsidiaries. A less ethnocentric approach tends to be more successful. For example, this could be done by engaging representation from multiple country subsidiaries to incorporate their diverse experiences into a common solution that is sufficiently flexible to be applied to all countries.

Conclusion

Internationalisation need not be difficult, but its complexity necessitates research into the differences and considered thought to be applied to the configuration, to allow diverse forms of knowledge to flow in multiple directions. One thing is certain: the "way we do things here" mindset will have to change at the corporate office if a firm is serious about sustaining internationalisation and seizing the immense growth opportunities that foreign markets offer.

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Reference

1 Prudential, "Prudential Completes Demerger of M&G Prudential", October 21, 2019.