Operationalising your expansion strategy

Globalizing your business into China through regional integration

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Introduction

Within the context of the BRICS initiative, in our consulting firm, we primarily consider the largely unresolved issue of whether wine producing companies should pursue an international strategy, i.e. globalization, through regionalizing their expansion strategy in terms of their market entry into China.

The context of this consideration is two-fold

One: A constant revision of current, relevant and appropriate literature on the matter.

Two: Practical experience of the Chinese macro- and micro-economic systems as exercised in various regions in local markets and places of trade. An explanation – recorded as a case study – of such micro-economic characteristics follows in the paper.

Allow me to differentiate between the terms globalization versus regionalization in this paper.

By globalization we refer to a method of international expansion through which the wine producer retains ownership and control of most of the upstream supply chain activities as a method of operationalising the expansion strategy, i.e. implementing it. By regional integration, or regionalization, on the other hand we include sharing or even shedding most of the up- and downstream supply chain activities as a method of operationalising the international expansion strategy.

The option of regional integration is brought about by the ambiguity in the empirical support for a globalization strategy, judging by the large amount of larger European and North-American organisations selecting regionalization as a preferred strategic choice of implementation (Rugman & Verbeke, 2004, 2005). In assisting organisations in their choice of expansion strategy and implementation, we consider both country specific advantages, as well as organisation-specific advantages that determine the method of operationalisation of an international expansion strategy.
Since the rise and sudden increase in globalization as a strategy of growth and expansion in the 1970s, strategists have been arguing the best possible approach to optimize the opportunities embedded in globalization.

Back in the 1980s, Hout, Porter, and Rudden (1982) suggested a portfolio approach in order to leverage a competitive edge in different countries. Levitt (1983), on the other hand, recommended standardizing a product for global distribution and cost competitiveness through increased volumes as an outcome of such expansion.

In their argument, Hamal and Prahalad (1985) suggested that global strategy requires product varieties by sharing core competencies in propriety assets across product lines.

Of course, as the era of, what Jeff Immelt – current CEO of GE – calls sweeping randomness of the business environment dawns onto us through unpredictable and random volatility in today’s marketplace, a global strategy becomes increasingly difficult to sustain due to the high requirement of organisational flexibility as a strategy of retaining sustainable competitiveness. This phenomenon, in part, plays a pivotal role in increasing larger organizations’ appetite to exercise a preference towards regional integration in terms of the expansion drive. The idea being that integration delivers increased responsiveness as organisations need to respond quicker to market trend changes.

This drive towards regional integration into China is currently seen by both larger, as well as smaller medium size enterprises (Johnson & Vahle, 2009; Lopez, Kundu, & Ciravegna, 2009) as an option to overcome part of the challenges of the fast-changing business environment. It is our recommendation to organisations within the wine industry who want to pursue an expansion strategy that they might want to consider decomposing integration through regional integration. In the case of China specifically, we favour regional integration strategy for lessons learnt out of practice.
Recorded case study example

Whereas the larger macro-economic and financial sector is fairly well regulated in China, it is the smaller micro-financing industry that contains high risk factors, causing us to recommend regional integration as a strategic option of expansion. This industry, as in most countries, also referred to as the micro-lending industry, is fairly unregulated and in cases where it is regulated, appear to be difficult to police.

The scenario below – based on a real case study – illustrates such risk. The risk relates primarily to the risk of defaulting on payment.

In the paper we exclude other less tangible risks, such as reputational and brand damage risk.

Of course, larger organisations tend to be able to fend the risk of defaulting payment better than those of medium and smaller size enterprises, but it is exactly our smaller enterprises that we so desperately need to grow as entrepreneurial entities and contribute to job creation in South Africa, that causes us to highlight such risks.

In a typical marketplace in downtown China, in any of your daily trading zones, one would find a micro-economic system at work, working more or less like this:

There would be a provider of funds – money – to buy and trade with. This person is generally known as the master. In our case – this would be your typical micro-lender. In the case of a larger more structured and regulated economic system, this would be your bank or private shareholder.

Then there are traders, or as we commonly refer to – suppliers. They would provide goods for sale to be bought and traded with, in the local communities around the marketplace. The suppliers could be suppliers of local and/or imported goods.

Those who buy from the suppliers are known as vendors. The regulation of this micro-economic system is one of self regulation, implemented and controlled by the master. The master would provide funds to both vendors and suppliers, but with the provision that neither may pursue trading independently, thus ensuring that his provision of money to trade and buy with will be in constant demand. In other words, if trader x wants to trade, funding for purchases, be that local or imported goods, are provided by the master with the
provision that the trader may not go on his own, i.e. ever trade using his or her own funding. On the other hand, if a vendor wants to purchase goods from the trader to further on-sell, the same provision of funds by the master applies. If a trader should attempt to bypass the master, the master will lend money to the usual pool of vendors with the provision that they may no longer buy from the trader that – according to him – double crossed him.

The question off course is, how does it happen that the trader can fund his or her going on their own. Do they fund it with their own money generated through profits of previous trading, or do they fund it through a change in payment terms with the exporter. We have found that in most instances, the second option is the preferable one. In other words, traders would initially buy their stock cash up-front, with money provided by the master. As the relationship between trader and exporter grows, the trader typically increases the order size and eventually asks for terms, or consignment, placing the risk of default in payment on the exporter. Reflecting on the dynamics of the micro-economic system of the marketplace, the trader will however now sit with stock that no vendor, by instruction from the master, will buy, and that is how, specifically smaller to medium size exporters expose themselves to risk.

A strategy of regionalization will mean building relationships not just with your immediate buyer, i.e. the trader/importer, but also with the master. It will bring the exporter of wine closer to the end-customer and allow for a better understanding of the marketplace, lessoning those so-called proverbial school fees to be paid.
Case study extract end

However, in terms of regionalization of your expansion strategy it is not merely local market dynamics that need consideration, but also your organisational size, managerial skills for coordination and integration (Barlett & Ghoshal, 1989), and other external factors. These factors, as points to consider, form the main drivers of a globalization strategy of regionalization. Based on the combination of regionalization strategy drivers, we advise organizations to consider the extend of integrating upstream and downstream supply chain activities and processes, or even a combination of both. Along with what we experience in practice, literature also alludes to multi-national enterprises; i.e. primarily exporters, considering a combination of organisation specific advantages and country specific advantages, coupled with their own organisational size, financial as well as managerial abilities.

Regarding expansion into China through regionalization, we advise organisations to not just focus on the opportunities that China holds, but also consider the costs and risks arising from distance (being far away from your immediate consumer market in that country), culture (language and behaviours specifically, values and ethos drivers that differs), administrative/political (regulation and ease of doing business, expatriating funds and so forth), geographical and economical dynamism. These factors relate primarily to country specific advantages, or disadvantages.

On the other hand, organisational specific advantages mentioned earlier also need to be considered, but as Buckley & Ghauri (2004) point out, organisational specific advantages do experience severe economical and inter-organisational resource flow challenges based on the simple matter of distance between exporter and importer.

Recommendations based on regionalization into China are as follows

As one option, we advise organisations to pursue building a competitive edge through knowledge transfer across borders and subsequent possible production in the host country. This, in the case of wine as a natural product, may only start at the point of bottling, but possible cultivating of vineyards is not ruled out totally.
Another option would be to increase their export market, in other words diversify their markets for purposes of risk mitigation, and in the process retain more ownership and control of upstream activities in the supply chain, but work with regional organisations in the respective markets as a means to regionalize the downstream activities of the supply chain.

The challenges in terms of supply chain dynamics, within which operationalisation materializes remain embedded in the supply and demand characteristics of the supply chain strategy. The relationship in such a case can be either with the Chinese importer, or with a possible retailer directly, should the organisation not want to pursue the market distribution route, referred to earlier.

To end this paper with, we provide two matrixes that we use in consulting with wine exporters into China. One focuses on the strategic selection of international expansion and the other on a method of operationalisation through regionalization based on the local area of trade and its supply and demand characteristics.

Figure 1: Regionalization based on country and organisation specific advantages (CSA and OSA)
1. In the case of low CSA and low OSA, we advise against any form of regionalization.

2. In the case of low OSA, but high CSA, we advise that the organisation globalize through regionalization, but retain control over its upstream supply chain activities. Relinquishing some downstream control does become a consideration though, in this quadrant.

3. In the case of high OSA, but low CSA, we recommend globalization through regional integration, but caution against relinquishing any up- or downstream supply chain control.

4. Finally, in the case of high OSA and CSA, we recommend full integration with a sharing or relinquishing of both up- and downstream supply chain control – in part.

Figure 2: Supply chain strategy based on supply and demand characteristics

<table>
<thead>
<tr>
<th>Long lead times</th>
<th>Lean plan and optimize</th>
<th>Hybrid De-couple through postponement</th>
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<tbody>
<tr>
<td>Supply characteristics</td>
<td></td>
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<tr>
<td>Short lead times</td>
<td>Continuous replenishment</td>
<td>Agile quick response</td>
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<tr>
<td>Predictable Demand characteristics</td>
<td>Unpredictable Demand characteristics</td>
<td></td>
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</tbody>
</table>

Source: Christopher, M. Logistics and Supply Chain Management. Pearson Education
1. In the case of the place of trade has high levels of predictability in terms of market demand as well as short lead times for the product, we recommend a continuous replenishment supply chain strategy.

**Example:** Larger bulk sales downstream into retailer – relinquishing downstream control.

2. In the case of predictability in terms of market demand, but longer lead times, we recommend a lean plan and optimize strategy.

**Example:** Diversification through customer profiling – longer lead times but against customisation of orders – supplying and airline, or bottling for specific events as examples. This is against fairly secure orders.

3. In the case of high unpredictability and long lead times, we recommend a hybrid decouple through postponement strategy.

**Example:** Bottle without labeling – retaining high levels of control upstream and making storing part of production. This is not against secure order, but more open trend analysis.

4. In the case of high unpredictability, but short lead times, we recommend an agile quick response supply chain strategy.

**Example:** Bottle for a spike in demand – retain high levels of integration up- and downstream.

**Conclusion**

Wine remains the only product at the dinner table that finds its way to the table in its original packaging. As a product it thus remains highly individualized and considers so many different likes and dislikes by a diverse international populace. Regionalization, as an option to increase your footprint into China, will assist in moving closer to the end-user, enabling better understanding of customer wants and needs and lead to a higher likelihood of increased long-term transactional relationships, competitiveness and business performance.
References


