UNDERSTANDING INTERNATIONALISATION BEHAVIOUR

Final Report: Annex

Report prepared for Ministry of Business, Innovation and Employment, Ministry of Foreign Affairs and Trade and the Treasury

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7 June 2013
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Introduction

1.1 BACKGROUND

As a small open economy, New Zealand is highly dependent on international linkages. Supporting the development of a more internationally competitive economy is a key policy target for the Ministry of Business, Innovation and Employment (MBIE), the New Zealand Treasury and the Ministry of Foreign Affairs and Trade (MFAT). As part of its Business Growth Agenda, the Government aims to increase the contribution of exports to the economy from 30 per cent to 40 per cent of GDP by 2025.

The study was jointly commissioned by MBIE, MFAT and the New Zealand Treasury. The study has been guided by a project Steering Group with representatives from each of the commissioning bodies. The aim of this study is to provide a more in-depth understanding of firms’ motivations to internationalise, the process by which internationalisation occurs and the challenges that firms face in internationalising. A range of forms of internationalisation were considered, including exporting and both inward and outward foreign direct investment.

In 2011 MBIE sponsored Module C of the Statistics New Zealand Business Operations (BOS) Survey which looked into the international engagement of New Zealand firms. As part of this module all firms were asked if they would participate in a follow-up survey. A sample of firms that agreed to take part in this follow-up study was interviewed to gather more in-depth information on the firm’s international engagement. The qualitative evidence gained from the interviews will supplement the quantitative information gathered in the 2011 BOS, providing MBIE, Treasury and MFAT greater understanding in this area to inform economic policy.

1.2 STRUCTURE OF THE REPORT

The report comprises five further sections starting with a review of the literature and emergent themes. In the second section called “Methodology”, the research design and process is presented followed by a description of the sample. The fourth section presents the results in ten thematic topic areas. The report closes with the final, fifth section on conclusions and implications of the research.

1.3 ACKNOWLEDGEMENTS

A special acknowledgement is offered to the business owners and managers that participated in the research by allowing us to visit them and their willingness to provide their valuable time. Without their cooperation we would not have been able to gain the rich, in-depth insights reported in this study. The authors are grateful for constructive comments made by independent reviewers on a draft version of this report. We are also grateful to Dr Jo Bensemann, Massey University, for undertaking an independent proofreading of the final report.

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1 Three independent reviewers made highly valuable and constructive comments on the draft final report: Professor Sally Davenport, Victoria University, Associate Professor Joanna Scott-Kennel, University of Waikato and Michael Freudenberg, New Zealand Treasury.
2 Literature review and emergent themes

The purpose of this section is to provide a review of the current literature and state of knowledge on the internationalisation process and provide themes that will be useful for framing the presentation of the findings and analysis of results.

Within the broad cross-disciplinary literature including aspects of international business, marketing and entrepreneurial strategy, a body of research has emerged on the subject of international entrepreneurship that McDougall and Oviatt (2000) view as 'a combination of innovative, proactive and risk-seeking behaviour that crosses national borders and is intended to create value in organisations'. A key issue involves a firm’s internationalisation strategy (Keupp and Gassmann, 2009) including entrepreneurs and management teams’ international market selection decisions (influenced by their perceived motives and problems) and the methods by which firms cross over national borders to create value for organisations.

Existing literature indicates that a single theory cannot explain firms' internationalisation (in a broad sense that includes de-internationalisation) strategies and this behaviour should be considered in a 'holistic' sense, i.e. recognising various aspects of particular theories in the context of individual circumstances affecting businesses over time (Bell et al, 2004; Jones and Coviello, 2005; Jones et al, 2011).

The focus of this commissioned study involves New Zealand firms’ internationalisation strategies and perceptions of key decision-makers; therefore it is important to review the literature in a broad sense and selected themes are identified separately to provide an academic underpinning for this investigation. Emergent themes from the literature review include: motives to internationalise, international market selection, de-internationalisation, internationalisation challenges and the New Zealand context, assistance and internationalisation, research gaps and the emergence of global value chains.

2.1 Motives to internationalise

The resource-based view

The issue of experiential knowledge and learning in entrepreneurs' decisions to expand overseas market activities to some extent links with the 'resource based view' of the firm. This takes an 'inside-out' firm perspective (Dickson, 1996) and resources can be identified from a number of perspectives e.g. financial, human-capital, etc. In short, these resources, broadly defined, are valuable, rare, inimitable and non-substitutable; as such, they allow the firm to develop and maintain competitive advantages (Barney, 1991).

Previous studies have found that key decision-makers’ characteristics drive organisational strategy including the resources that he/she is prepared to invest based on the perceived attractiveness of market opportunities, for example, their orientation towards overseas expansion often results in higher international involvement (Cavusgil, 1984; Chandler and Hanks, 1994; Katsikeas, 1996). As such, issues associated with entrepreneurial cognition are clearly important. This orientation extends to the management team in certain cases where joint decision-making takes place (Reuber and Fischer, 1997), i.e. as experience develops, this is
utilised in the formation of strategies and the allocation of resources; not least of which involving the minimisation of transaction costs. Consequently, assistance and training can be used to develop know-how and to help facilitate an international orientation for management teams. Therefore, elements of the ‘resource based view’ of the firm can partly explain entrepreneurs' internationalisation strategies (Andersen and Kheam, 1998; Westhead et al, 2001; Kundu and Katz, 2003).

**The network approach**

It has been suggested that an entrepreneur or the management team is sometimes able to draw upon established international networks to facilitate internationalisation (Coviello and Munro, 1995; 1997). The relationships that form the networks can occur within personal or business contexts and these act as communication infrastructures where common interests are shared (Hallén, 1992). Network partners can assist internationalisation in a whole host of ways. For example, potential business partners and clients, business representatives and ordinary citizens enable entrepreneurs to gain insight into how business is conducted, to demonstrate interest, and to start the process of building trust in overseas markets (Wilson and Mummalaneni, 1990). This is particularly important when firms start to internationalise (Lindqvist, 1997). The usefulness of networks, including those with support providers, extends past the development of market knowledge. They could provide, among other things, synergistic relationships with other firms, small and large, which complement each other’s resources at various stages in the value chain (Welch and Welch, 1996; Keeble et al, 1998; Dana et al, 1999; Welch and Welch, 2004).

In the context of the present study, network relationships and assistance including training providers, may help facilitate internationalisation decisions. For example, trade assistance may encourage the establishment of networks, or recruitment of new staff with established networks, that could result in knowledge development and joint activities (Welch et al, 1997; Spence and Crick, 2001). However, the usefulness of certain assistance providers in these network relationships has been questioned, not least of which including government policy makers. Chaudhry and Crick (2002) argue that a credibility gap has been found to exist between entrepreneurs and government officials, but proceed to point out that policy makers are responding to such criticism, e.g. by facilitating assistance through various routes including new technology to assist decision-making. Therefore, the utility of maintaining these network relationships with training and support providers remains important in order that entrepreneurial learning can be facilitated via the most appropriate route. Consequently, certain elements of network theory can help to explain entrepreneurs' internationalisation decisions.

**The contingency view**

The ability to generalise from theories in categorising internationalisation behaviour and their usefulness in the provision of assistance and training has received criticism in various studies (see, for example, Turnbull, 1987; Edvardsson et al, 1993; Bell, 1995; McAuley, 1999; Zahra et al, 2000; Bell et al, 2004). For example, it has been suggested that the 'stage' models may be more suitable for firms in low-tech, manufacturing sectors rather than those in high-tech and service sectors (Bell et al, 2004). High-tech firms are often characterised by having a narrow product scope, fast obsolescence of their products and a limited domestic demand, especially in small countries.
This has led to what has become known as ‘international new ventures’ or the ‘Born Global’ phenomenon, although some studies have used the terms interchangeably and the lack of distinction has led to certain authors calling for the need to distinguish between firms based on the speed, scale and scope of their internationalisation paths (Chetty, and Campbell-Hunt, 2004; Rugman, 2006; Lopez et al, 2009; Crick, 2009). Some studies have linked rapid internationalisation with performance suggesting certain entrepreneurs are able to exploit windows of opportunity to gain a competitive advantage (Gassman and Keupp, 2007; Gleason and Wiggenhorn, 2007; Kuivalainen et al, 2007). Therefore, some firms in high-tech oriented sectors must have an international focus from the start-up phase of their business life cycle (Oviatt and McDougall, 1994; 2005; Knight and Cavusgil, 1996; 2004; Madsen and Servais, 1997; Andersson and Wictor, 2003; Nummela et al, 2004; Zahra, 2005; Acedo and Jones, 2007). In respect of the provision of assistance and training, it has been recognised that in environments that are rapidly changing, how quickly entrepreneurs learn to adapt is sometimes more important than prior acquired knowledge (McDougall et al, 1994; Autio et al, 2000).

In terms of assisting entrepreneurs to overcome problems and learn from experience, research has found that the internationalisation decision is often iterative rather than linear. Consequently, entrepreneurs may change the extent to which they select and serve particular international markets and through different modes of market entry, i.e. other than exporting, in the light of dynamic environmental conditions (Calof and Beamish, 1995; Oesterle, 1997; Bell et al, 2004). The utility of offering firms faced with such an environment, standardised assistance and training programmes, has therefore been criticised.

Spence and Crick (2006) found that some entrepreneurs were influenced by what they term as ‘serendipity’, i.e. chance events affected their international market selection and servicing decisions. However, they warn that care must be taken in calling certain events serendipitous since to some extent entrepreneurs in their study made their own luck by scanning for opportunities. They draw on the work of Sarasvathy (2001) arguing that entrepreneurs formulate decisions based on a non-linear and iterative process called ‘effectuation’ and argue that this is a difficult issue to model since the way in which one person reacts to the same event is likely to be different to another.

Therefore, it is difficult to offer training and support addressing entrepreneurs' reactions to serendipitous events. Additionally, this is an issue that is problematic to teach in training sessions; arguably, strategy formation sometimes dominates class discussion whereas entrepreneurs often react to situations with ‘emergent’ rather than strategic planning (Crick and Spence, 2005). Consequently, whereas some environmental issues can be planned for and support, including training, can assist in this, it is difficult to anticipate other factors and a fluid decision making style needs to be adopted in some firms (Merrilees et al, 1998). There is a need for policy makers to support events such as trade fairs and overseas missions that generate serendipitous meetings and the development of networks (Scott-Kennel, 2013, 124). This recognition that internationalisation is affected by multiple influences supports the belief that a contingency view partly explains entrepreneurs’ internationalisation decisions (Reid, 1983; Woodcock et al, 1994; Yeoh and Jeong, 1995; Kumar and Subramaniam, 1997; Ibeh, 2003).
## 2.2 International Market Selection

As Alon (2004) suggests, international market selection is an important component of a firm’s internationalisation efforts because of the impractical nature of attempting entry into all nation states. Not all markets have the same potential (based on issues such as perceived motives and problems in internationalising) and so entrepreneurs need to consider where to expend their efforts and limited resources. In making this consideration, Brewer (2007) suggests that knowledge of the markets is an intuitively obvious key issue in selecting profitable markets if an entrepreneur is not to rely on chance. However, Sakarya et al (2007) highlight the importance of also looking at opportunities in emerging markets in addition to more traditional ones in which entrepreneurs are likely to have more knowledge in making international market selection decisions.

It has been argued that in making international market selection decisions a planned screening process is desirable (Rahman, 2006). For example, Kumar et al (1993) highlight the importance of screening, identification and selection stages in decision-making. Koch (2001) suggests that a number of internal, external, and mixed (i.e. a combination of internal and external) factors can be part of entrepreneurs’ decision-making process based on the characteristics of a firm, whilst Rahman (2003) provides a set of issues termed micro and macro factors. Nevertheless, Papadopoulos et al (2002) argue that models have not been tested sufficiently or for that matter provide little evidence that they can predict market attractiveness and/or are too complex to use in practice. However, Brouthers and Nakos (2005) draw linkages between a systematic market selection process and a firm’s performance, finding that on average the more systematic a firm’s international market selection was in targeting foreign markets the better it performed. Even so, certain studies have found that the decision can in some cases be based on non-systematic criteria (Papadopoulos and Denis, 1988) e.g. based on a key entrepreneur or management team’s commitment and personal beliefs about factors such as market potential through to the acceptance of unsolicited orders (Spence and Crick, 2006).

Turning now to the internationalisation process more broadly and the assistance entrepreneurs may require facilitating this, over the last couple of decades a wide body of knowledge has entered the academic domain. Indeed, a number of categorisations have been proposed to describe this (see, for example, Andersen, 1993; Leonidou and Katsikeas, 1996; Coviello and McAuley, 1999; Jones, 1999). Historically, policy makers have been found to use such categorisations in the provision of trade assistance. For example, while now dated, Crick (1995) found that UK policy makers used a three-stage classification of non-exporters, passive and active exporters in their targeting of support for internationalising firms and similar categorisations have been proposed elsewhere (Czinkota, 1982; Campbell, 1987).

Existing categorisations or models have taken an outward perspective in describing entrepreneurs’ market selection and servicing decisions. They view internationalisation as a process starting from the point that firms serve their domestic markets (pre-export) and move through various processes that some studies refer to as ‘stages’, until they are committed to serving geographically dispersed markets. In some categorisations this includes serving these markets via entry modes other than the exporting route e.g. subsidiaries. It has been typically suggested that entrepreneurial decisions often follow a systematic and sequential process
commencing with a culturally similar country e.g. New Zealand firms going to Australia to obtain experience in a country perceived as possessing a limited risk. Subsequently, decisions are taken to serve international markets that are seen as more culturally dissimilar and possessing more risk.

2.3 De-internationalisation (International Market De-selection)

Recent work has identified firms that internationalise in a different manner to that postulated in earlier work, allowing a more dynamic interpretation, i.e. firms either stop overseas activities or move in and out of various markets (Pauwels and Matthyssens, 1999). In other words, in extreme cases the international market selection decision discussed in earlier research now becomes reversed whereby there is a focus on a firm's domestic market. Benito and Welch (1997) argue that de-internationalisation as an outcome for a firm can be viewed as a set of factors linked to past international operations and commitments, but is also affected by current developments within and external to the company. Depending on the severity of problems and the commitment of entrepreneurs and resources, this may affect a decision to turn round the situation or lead to market withdrawal. Importantly, Welch and Wiedersheim-Paul (1980) suggest that withdrawal from international markets should not always be seen as a market failure since this depends on issues such as entrepreneurs' aims and strategies employed. Indeed, several studies have identified firms that move in and out of markets for various reasons although in these studies they had not totally withdrawn from all overseas markets (Crick and Jones, 2000; Bell et al, 2004).

Bell et al (2001; 2003) introduce the term 'born-again globals' that represent firms that may have internationalised some time ago, but for some reason have pursued a domestic market strategy for some while. They proceed to suggest that critical incidents such as a change in management or ownership, a fresh infusion of capital or a change in scope of a domestic customer may affect entrepreneurs' international market re-selection decision. Firms in their study suddenly underwent rapid and structured internationalisation after what might be termed as a 'critical incident'. It is therefore important that assistance and training can support entrepreneurs that meet such a profile to facilitate, if required, a 're-internationalisation' strategy.

However, in respect of the decision to concentrate on the domestic market, Crick (2004) identified two groups of entrepreneurial decision making, namely those that withdrew from overseas markets as a short-term (termed 'disappointed' firms) in comparison to a long-term strategy (termed 'disinterested' firms) suggesting that different issues influenced the respective entrepreneurs and management teams' international market de-selection decisions. Those that withdrew from overseas markets on a short-term basis were largely influenced by factors associated with competitiveness whereas those that withdrew on a longer-term basis tended to be influenced by more significant issues such as the ability to gain representation.
2.4 INTERNATIONALISATION CHALLENGES AND THE NEW ZEALAND CONTEXT

New Zealand is a small open economy that is dependent on international trade, but is also distant from larger overseas markets. The openness of her economy, coupled with distance from major overseas markets, create challenges for New Zealand businesses that are unique for a small developed economy that is an OECD member. For example, comparisons are sometimes drawn between New Zealand and small peripheral, but developed economies in Europe such as Ireland, Denmark and Finland yet none has the same challenge of remoteness. Despite the stalling of the World Trade Organisation’s Doha round of talks, reduction in trade barriers is still an important part of the agenda with the Doha Development Agenda (WTO, 2012) and increased globalisation has seen a liberalisation of trade and a reduction of tariffs in this century. This has opened up new markets for NZ businesses, but distance remains a challenge (Chetty and Campbell-Hunt, 2004).

It is recognised that for NZ businesses, distance has at least two dimensions. The first is physical distance with the lead time and cost involved in transport and freight, especially for businesses involved in the manufacturing sector. Second, is the concept of ‘psychic distance’ which operates through perceptions of business owners and managers. For example, Australia is our closest overseas market physically, but psychologically we feel closer to our Antipodean neighbour than we do to other nations of different cultures and languages which may be perceived as having different business regulations. These challenges have been described as ‘dimensions’ of internationalisation that are unique to New Zealand (Scott-Kennel, 2013; Taylor and Jack, 2011).

2.5 ASSISTANCE AND INTERNATIONALISATION

Much has been written about the perceived usefulness of government support and training to assist experiential learning plus the most appropriate methods to enable this to take place (Czinkota, 1982; Welch et al, 1997; Crick and Jones, 2000). For example, Crick and Jones (2000) found that a number of entrepreneurs in their sample perceived that international trade assistance was more appropriate for those with limited experience and especially among firms undertaking an exporting mode. Entrepreneurs typically perceived that support, including training, was largely of a ‘how to export’ nature. More specific assistance for experienced entrepreneurs, especially those wanting to undertake modes such as licensing, joint ventures etc. in specific international markets, was rather lacking from policy makers as entrepreneurial learning had already taken place for many day to day activities.

2.6 RESEARCH GAPS

As Coviello and Jones (2004) highlight, a methodological gap exists in the internationalisation literature concerning longitudinal studies or at the very least as Jones and Coviello (2005) suggest that there is a need to address the issue of how strategies change over time. This suggests that qualitative and longitudinal studies rather than (or certainly in addition to) statistical analysis may be useful in studies of this nature. Moreover, a good deal of the previous studies have tended to adopt an outward internationalisation focus investigating the international market and entry mode selection decisions rather than considering the international market de-selection decision i.e. a focus on the firm’s domestic market instead (Welch and Wiedersheim-Paul, 1980; Benito and Welch, 1997; Pauwels and Matthyssens, 1999; Crick, 2004). This limited existing literature on ‘de-internationalisation’ has indicated
that this should not necessarily be seen as ‘failure’ and has largely neglected the issue of ‘time’ i.e. how strategies changed in a longitudinal sense as some firms may enter and leave markets regularly rather than totally withdraw from all overseas markets.

2.7 The emergence of global value chains

An area that has become of interest to policymakers is the extent to which firms are able to participate in global value chains (GVCs). GVCs have become more important with the increased globalisation of economic activity. In GVCs different stages of the production process are located in different economies, thus it is theoretically possible for a New Zealand firm to be engaged in exporting as part of a global supply chain and those that do participate are increasingly connected across different international economies. In theory, a firm’s ability to participate in GVCs will depend on infrastructure and associated costs such as freight, but also with developments in areas such as ICT and fast broadband. Although the emergence of GVCs has attracted a great deal of attention, we note here that there has been little international comparative work on measurement. However, an OECD paper (de Backer and Yamano, 2012) has indicated that economies with high trade/GDP ratios have greater participation in GVCs. According to Backer and Yamano (2012) New Zealand’s ratio is relatively modest (30%), coming 29th out of 36 OECD countries on this measure of GVC. For this report, we make comments on participation in GVCs, but it was not a specific objective of the research.

2.8 Summary

This literature review has indicated that, in seeking to understand internationalisation behaviour, it is necessary to draw on a number of explanatory theories including those based on resource and dynamic capabilities, those based on networks and trusted relationships and those based on contingency and adaptive capacity. At the same time, it is important to realise that firms may strategically withdraw from overseas markets or de-internationalise. Therefore, we can expect that the pattern of internationalisation behaviour will be complex and vary across types of businesses, sectors and markets. Nevertheless, the themes identified in this section will help to provide a framework reference for the subsequent analysis. The emergence of GVCs is a phenomenon of interest to policymakers and, where relevant, reference will be made to these in the analysis. The theoretical framework and emergent themes are illustrated in Figure 1.
Figure 1: Theoretical and thematic framework
3 Methodology

The research comprises face-to-face, in-depth interviews with 98 businesses with different levels of international engagement. A staged approach was undertaken with regard to the completion of the interviews. The approach comprised two stages, in which data collection and analysis was an iterative and reflective process to progressively refine the research focus and to verify emerging themes (Srivastava and Hopwood, 2009).

The research design followed Massey University’s Code of Ethical Conduct for Research, Teaching and Evaluations of Human Participants was peer reviewed and consequently judged to be low risk.

3.1 Sample Selection

The sample arose from the Business Operations Survey (BOS) that is administered annually by Statistics New Zealand. In 2011 MBIE sponsored Module C of the Business Operations (BOS) Survey which looked into the international engagement of New Zealand firms. As part of this module all firms were asked if they would participate in a follow-up study.

Statistics New Zealand completed a quantitative profiling of the 2011 BOS data, which is independent of this study. The resulting profiling is illustrated in Figure 2 and included categorising businesses depending on the level and type of their international engagement, changes in overseas markets and future intentions for overseas markets.

![Figure 2: International engagement and activity](image-url)
As indicated in the previous section, international behaviour can be complex with a diverse pattern across different types of firms and different sectors. The sampling was designed to capture some of this complexity. Following a small number of pilot interviews and refinement of questions, the first stage involved 60 interviews across a diverse sample of internationally active and non-active businesses. This stage was completed between June and July 2012. For the second stage we purposefully selected businesses from only one sector – the services industry and included 20 interviews with businesses that are actively engaged in international markets and 18 interviews with businesses that were not currently engaged in international activities. This stage was completed in October 2012.

3.2 Data collection

All participants were initially contacted by phone to seek their participation in the research. Data was collected through face-to-face interviews using a semi-structured interview approach. In keeping with our philosophical approach of seeking to understand the internationalisation process, we carefully designed the interview structure to be non-threatening and to minimise the risk of socially desirable responses. It was important to allow respondents to talk through issues that were important to their business. This meant that a wide range of issues were covered and reliance was placed on the skills and experience of the researcher to obtain relevant and meaningful data.

The interview structure covered a broad range of themes that were flexibly arranged depending on the firms’ international experience.

- Background: This initial section explored details about the firm and the context in which it is operating.
- Internationalisation process: In this section we explored the firms’ current engagement, including the history of the firms’ involvement in internationalisation and future developments. We also explored the lessons firms have learned and their sources of information.
- Internationalisation pattern: In this section we explored the types of international activity that firms engaged with and the sequencing of these activities.
- Location of activity: This section explored why firms operate in particular locations.
- Disengagement from internationalisation: In this section we explored why firms have withdrawn from international activities or markets.
- Non-engagement with internationalisation: In this section we explored how firms compete in the domestic market and what they thought about potentially engaging in international activities.
- New Zealand environment: In this section we explored how the New Zealand environment affects firms’ ability to compete internationally.

The interview structure was constantly reviewed and refined to reflect emerging issues.

In all cases, notes were made during and immediately after the interview to capture issues raised at the time and to record immediate thoughts and observations of the researcher.

Interviews took place on the businesses premises and averaged around one hour. Informed consent was obtained and, with the permission of the interviewees the interviews were recorded and transcribed. The transcript was shared with the
interviewees to give opportunity to amend and augment the initial responses or to withdraw the transcript completely.

3.3 DATA ANALYSIS

The first step in the data analysis was to write up a descriptive case summary for each interview to ‘allow for the unique pattern of each case to emerge’ (Eisenhardt 2002, p18) and to capture the diverse international patterns. Subsequently all interviews were coded using an open coding approach (Strauss and Corbin, 1990) to identify common themes. Axial coding was used to identify relationships between the themes and to build a theoretical framework. Finally, selective coding was used to support the emerging framework.
4 Sample description

Before presenting the results, some notes on the demographics of the sample are useful. Respondents interviewed represented a very diverse range of firms and varied in the extent of their internationalisation behaviour.

Reflecting the aims of the study, the majority of our respondents were selected from those that were internationally active, but the sample also included non-active firms. In total, 70 per cent of firms in our sample were currently internationally active, compared to 30 per cent who were non-active firms.

From the 98 firms in our sample, 35 per cent were small in size (6-19 RME\textsuperscript{2}), 41 per cent medium (20-99 RME) and 24 per cent large (100+ RME). Across the two stages, internationally active firms tended to be larger compared to internationally non-active firms. While 57 per cent of internationally non-active firms were small in size, only 26 per cent of internationally active firms were. The number of medium sized firms was roughly similar across internationally active and non-active firms with 41 per cent and 38 per cent respectively. Finally, 33 per cent of internationally active firms in our sample were large in size, compared to only 4 per cent internationally non-active firms.

Table 1 provides further details on the sample for internationally active and non-active firms including: age of the firm; the extent of international experience, the number of markets and the importance of different overseas markets.

\textsuperscript{2}RME stands for rolling mean employees. It is a twelve month moving average of the monthly employment count obtained from taxation data.
<table>
<thead>
<tr>
<th>Firm size</th>
<th>Stage 1</th>
<th>Stage 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Active</td>
<td>Non-active</td>
</tr>
<tr>
<td></td>
<td>n (%)</td>
<td></td>
</tr>
<tr>
<td>Small 6 - 19 RME</td>
<td>12 (24)</td>
<td>5 (50)</td>
</tr>
<tr>
<td>Medium 20 - 49 RME</td>
<td>8 (16)</td>
<td>3 (30)</td>
</tr>
<tr>
<td>Medium 50 - 99 RME</td>
<td>11 (22)</td>
<td>1 (10)</td>
</tr>
<tr>
<td>Large 100+ RME</td>
<td>19 (38)</td>
<td>1 (10)</td>
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<table>
<thead>
<tr>
<th>Age</th>
<th>Stage 1</th>
<th>Stage 2</th>
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<tbody>
<tr>
<td></td>
<td>Active</td>
<td>Non-active</td>
</tr>
<tr>
<td></td>
<td>n (%)</td>
<td></td>
</tr>
<tr>
<td>5 years and younger</td>
<td>4 (8)</td>
<td>1 (10)</td>
</tr>
<tr>
<td>6 - 10 years</td>
<td>9 (18)</td>
<td>2 (20)</td>
</tr>
<tr>
<td>11 - 15 years</td>
<td>8 (16)</td>
<td>3 (30)</td>
</tr>
<tr>
<td>16 - 20 years</td>
<td>9 (18)</td>
<td>1 (10)</td>
</tr>
<tr>
<td>21 years and older</td>
<td>20 (40)</td>
<td>3 (30)</td>
</tr>
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<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Active</td>
<td>Non-active</td>
</tr>
<tr>
<td></td>
<td>n (%)</td>
<td></td>
</tr>
<tr>
<td>5 years and less</td>
<td>8 (17)</td>
<td>- (-)</td>
</tr>
<tr>
<td>6 - 10 years</td>
<td>2 (4)</td>
<td>- (-)</td>
</tr>
<tr>
<td>11 - 20 years</td>
<td>17 (35)</td>
<td>- (-)</td>
</tr>
<tr>
<td>21 years and more</td>
<td>21 (44)</td>
<td>- (-)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>No of markets</th>
<th>Stage 1</th>
<th>Stage 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Active</td>
<td>Non-active</td>
</tr>
<tr>
<td></td>
<td>n (%)</td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>- (-)</td>
<td>10 (100)</td>
</tr>
<tr>
<td>1 - 5</td>
<td>24 (48)</td>
<td>- (-)</td>
</tr>
<tr>
<td>6 - 10</td>
<td>13 (26)</td>
<td>- (-)</td>
</tr>
<tr>
<td>11 and more</td>
<td>12 (24)</td>
<td>- (-)</td>
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<table>
<thead>
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<th>Market served</th>
<th>Stage 1</th>
<th>Stage 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Active</td>
<td>Non-active</td>
</tr>
<tr>
<td></td>
<td>n (%)</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>43 (86)</td>
<td>- (-)</td>
</tr>
<tr>
<td>Pacific</td>
<td>21 (42)</td>
<td>- (-)</td>
</tr>
<tr>
<td>India</td>
<td>7 (14)</td>
<td>- (-)</td>
</tr>
<tr>
<td>Japan</td>
<td>18 (26)</td>
<td>- (-)</td>
</tr>
<tr>
<td>China</td>
<td>19 (38)</td>
<td>- (-)</td>
</tr>
<tr>
<td>US</td>
<td>22 (44)</td>
<td>- (-)</td>
</tr>
<tr>
<td>UK</td>
<td>22 (44)</td>
<td>- (-)</td>
</tr>
<tr>
<td>Other Europe</td>
<td>19 (38)</td>
<td>- (-)</td>
</tr>
<tr>
<td>Middle East/Africa</td>
<td>18 (36)</td>
<td>- (-)</td>
</tr>
</tbody>
</table>

*Table 1: Sample statistics*
5 The process of internationalisation

The theoretical framework developed from our literature review in chapter 2 suggests that there are a number of explanatory theories for why some firms internationalise, why others do not and why internationalisation behaviour itself is variable across different firms. Likewise the process of internationalisation will also vary across initial entry decisions, activities, disengagement and changes in behaviour over time. This dynamic process is examined through the initial entry decision and subsequent internationalisation behaviour and activities.

5.1 UNDERSTANDING THE DECISION TO INTERNATIONALISE

The factors that drive a business’s initial decision to internationalise are diverse and multifaceted. The decision may be influenced by the small size of the domestic market in New Zealand viz-a-viz the need for businesses to grow. Even here, however, there are different variations of the market saturation and growth theme that illustrate the complex and dynamic nature of the internationalisation process. The dynamic nature of this process is illustrated through some of the explanatory factors here including the need to manage risk, the competitive nature of the domestic market, following clients and unsolicited enquiries.

5.1.1 The desire to grow and the need to survive

The initial decision to internationalise was frequently prompted simply because businesses had exhausted their potential to grow in the New Zealand domestic market. In order to expand and grow, these businesses have the choice to either look off shore or pursue other strategies such as diversifying into areas outside their core activities. For example, the respondent from case #14, a large NZ-owned company in the manufacture of electronic switchboards that had established a strong domestic base, commented on the motive for internationalisation.

"We’re quite a large player in the market in New Zealand and whilst there’s still room to grow in New Zealand and expand into areas outside of the core area, the real growth opportunities sit overseas. #14"

For other business, however, internationalisation is not only the best option to grow, but the only option to survive. An exemplar is case #32, a medium-sized, high-value manufacturer of marine fittings. Operating in such a niche market meant that this business had to internationalise in order to survive.

"You have got to look elsewhere otherwise you are toast. #32"

Another example is case #45 a medium-sized, low value manufacturer of shelving solutions. In order to keep its market share and stay competitive in the New Zealand market, this business had to invest in new machinery with better technology. But to fund this investment, the business needed higher volumes which they could only achieve in overseas markets.

"To purchase more machinery with better technology we needed a bit more volume. #45"

The dynamic nature of this decision to internationalise meant that the initial objectives had been based upon growth within a domestic market. Establishing a strong domestic base was important for many businesses. In this respect such behaviour fits into a resource-based view of the firm that seeks to establish a strong resource and capability base in the domestic market before seeking growth and..."
diversification through internationalisation activities. Thus, such businesses considered their strong domestic market share as vitally important to fund their overseas activities. A number of firms commented on the link between their strong domestic presence and their success in international markets indicating that firms are using internal capital (resources) to fund internationalisation activity. Again the respondent from case #45 commented on the importance of a strong domestic base market.

You definitely need a reasonable local market so you can afford to export, to help fund it. #45

5.1.2 Managing Risk
For some businesses, particularly in primary industries, the decision to internationalise was primarily a risk management strategy. Those businesses tended to be affected by seasonal fluctuations and unpredictable weather patterns. Together with long production lead times this meant that planning and forecasting was very difficult. Case #21 is an NZ owned medium-sized company with products applied in agri-business and aquaculture sectors. The respondent commented that operating in a diverse range of markets allowed the firm to better manage this risk.

We are a rural supplier which means we are dependent on the vagaries of the weather, drought versus the wet season versus normal season. So it starts to come down to the diversity of markets so that if Australia is in drought and not going well, one would hope that Waikato is having the best year ever and it will help balance out with volumes and profitability, maybe in a different area, it’s all about spreading risk. #21

5.1.3 Internationalisation in the face of increased competition
While some firms may internationalise to ensure growth, others may face increased competition domestically which may bring forward a decision to internationalise. For example, there were a small number of firms within the engineering and print industry that were facing a squeezed domestic market through increased and intensified competition. The competitive nature of their industry led them to look for opportunities off shore. These businesses experienced less competition overseas, particularly in Australia, which allowed them to be more profitable. Case #23 is one example of a medium sized company facing increased competition in the electronics sector, where domestically the market had matured. The respondent commented on the need to seek alternative markets.

“It’s about moving away from the crowded market here where we have got more competitors. We can fly under the radar and operate a bit more freely over there. #23”

5.1.4 Following clients
A further example of the dynamic nature of internationalisation behaviour in practice being driven by having first established a strong domestic base was revealed through initial enquiries coming from established clients who had moved overseas – or following clients. A number of businesses supplied their products to multinational companies that operate in New Zealand. While these businesses initially only supplied the New Zealand market, a strong track record and good relationships with the multinational company opened up the opportunity to supply their products in overseas markets. These businesses followed their clients to whatever market they were operating in. For example, case #28 is a medium sized NZ owned company in the competitive print sector and the respondent commented on the development of international activity.
We do all the [name of client] service stations in New Zealand, and [name of client] wanted consistency with branding. So we started doing some of the service stations overseas and that’s how it originated. So it was driven from one of our major clients. #28

5.1.5 Unsolicited enquiries
In some cases, the international activity was triggered by unsolicited enquiries from overseas. Enquiries typically came from agents, distributors or customers. For example, case #60 a NZ owned small sized company, low-value manufacturer of hosiery. The respondent commented on the nature of unsolicited enquiries.

Most of our export people have approached us and we haven’t actually actively gone out and pushed ourselves there. The one in Canada was actually buying our product from a customer of ours and then decided to contact us directly and that’s how it started. #60

All of the aforementioned factors are related to the nature of the market. While these market triggers were important for the business internationalisation they tended to come in combination with two other areas that were related to the nature of the management and resource capability: the ability to recognise opportunities and a longer-term international orientation.

5.2 Resource capability
The decision to internationalise is dependent on business resource capability, although, as we have indicated, the initial enquiry or opportunity may be serendipitous such as following clients who relocate overseas. Resource capability may exist internally, but it is also likely to be added to through networks and trusted relationships. It is examined in more detail below to gain a better understanding of how opportunities are exploited.

5.2.1 Ability to recognise and exploit opportunities
A number of internationally active businesses have commented on their management’s ability to recognise and more importantly exploit opportunities overseas. For example, the respondent from case #14 commented on the development of contacts as part of the process of exploiting opportunities.

Anyway, he travelled round looking for opportunities for that heavy engineering side of things. That sort of helped us build up some contacts. #14

The importance of resource capability can be illustrated from case #63, an owner-manager of a small company specialising in providing a niche service to the travel industry. Over time the business had built a database and regular periodical publications to their subscribers who are all NZ-based. This resource base proved attractive to overseas clients looking to either ‘purchase’ the database or place adverts. The respondent had over 25 years’ experience and had built up the business by developing the database. Most of their overseas income is generated from Australia with some from the Asia-Pacific and overseas income accounts for around 10-15% of income for the business. The respondent commented on the nature and value of this resource to potential overseas clients.

We built up a database that we could break the mailing and e-mail list up into several regions within New Zealand and then within that region down to the towns and cities, so we can do flyer distribution. We process because the travel industry deals in intangible products. #63
In this case the resource base included the business’s reputation and trust that had been developed within the industry over time.

Internationally non-active businesses provided contrasting examples where opportunities were recognised, but not necessarily exploited. In some cases, the reasons for non-exploitation were quite practical such as difficulties in containerisation or lead times. In other cases, the reasons were more subtle and due to motivations and ambitions of the owners or previous experience.

For example, by contrast to the case above, we can consider case #64. This was a long established small company in denture technology; the owners had gradually built the business, through slow but steady growth to its present size over 22 years. The owners had made a decision not to engage in international activity because of an internal decision to retain control over quality. The respondent owner commented that they were concerned to safeguard their established reputation.

*The other thing that's happening in the industry which is causing a bit of alarm is there’s a lot of work being sent across to China to be made, a lot of partial dentures and the quality is poor. You can’t guarantee what’s gone into that product either and yet they’re still charging top money.* #64

In a similar vein, a company may decide against the development of opportunities for overseas income due to concern with quality and the impact on reputation. For example, case #74 was a company involved in the tourism sector and, although earning overseas income, had decided against exploiting additional opportunities overseas because of concerns with potential damage to its reputation and negative effects on the brand.

*Partly because we’d also be actually end up competing with our own brand, all of a sudden there’s twenty [brands] around the world, and so you lose your exclusivity a bit.* #74

5.2.2 International orientation and longer-term commitment to international growth

As discussed earlier, a great deal of the literature has identified the crucial role played by the entrepreneur or management in the internationalisation process. Engagement in internationalisation is highly dependent on the entrepreneurs’ or management’s orientation towards foreign markets. Those with a positive orientation towards foreign markets are considered more likely to commit more resources towards building international markets. An exemplar is the managing director of case #27, a NZ owned small sized company and manufacturer of specialised mowing equipment. The MD trained in the US in his early career days and had accumulated extensive international experience.

*People fascinate me; the diversity of the world is so interesting. […] I was in the US in the early seventies when the US was in its heyday. It was great, but I suddenly realised there was a huge world out there. I always remember when I left to come back, I said to myself “one day I’m going to come back and sell these guys something”.* #27

It was noted that the majority of respondents from internationally active businesses had worked overseas and brought that international experience back to New Zealand. They tended to have much more of a global outlook and longer-term commitment to international growth. For example, case #05, a NZ owned highly specialised manufacturer of mining and quarrying equipment. As commented by the respondent, in this case, a change of management was necessary to achieve this global outlook and commitment to international growth.
I think there needs to be strong support from shareholders. There’s got to be an appetite that you are going to grow outside of New Zealand and that that’s not going to provide a return on day one. A longer term view and there’s got to be strong support there. Through this process we’ve had a change of shareholders effectively. #05

Long term entrepreneurial commitment to developing an overseas market was illustrated by case #81. A NZ owned company, medium-sized, listed on the NZ alternative stock market involved in wind technology that had established a product for the NZ environment capable of operating in turbulent wind conditions. Having established that base they were seeking to develop a target overseas market with similar turbulent wind conditions. The company were actively pursuing global markets and had already secured a licensing deal with General Electric for North America and Africa, although they did not currently have overseas orders. The respondent from this company was passionate about their product and commented on how they had arranged a demonstration ‘sale’ so that the product could be seen working overseas.

What we’ve done is we’ve put up the finance and, through a subsidiary company, leased the land from the farmer, pay him a revenue and after so many years if he sees it goes well, that it doesn’t break down, he’ll then buy it from us. At least we have a demonstration model, so it’s not really a sale. #81

5.3 Internationalisation Process in Practice

Findings from this study support a staged approach to internationalisation. The internationalisation process of the majority of cases probably fit this model best and it follows from the need to investigate opportunities, build key relationships, have people employed “on the ground” overseas and to understand the needs of overseas markets. According to the stages’ approach or Uppsala model firms start by serving their domestic market and move through distinct stages, until they are committed to serving geographically dispersed markets. This includes serving these markets via entry modes other than the exporting route e.g. subsidiaries. It has been typically suggested that entrepreneurial decisions often follow a systematic and sequential process commencing with a culturally similar country e.g. New Zealand firms going to Australia to obtain experience in a country perceived as possessing a limited risk. Subsequently, decisions are taken to serve international markets that are seen as more culturally dissimilar and possessing more risk. For example, it has been suggested that this process develops on the basis of entrepreneurs gaining information and perceiving risk differently based on experiential learning.

However, there are also examples of firms that could be categorised as “born global businesses” (BGBs). BGBs have an accelerated internationalisation process. These firms, of which we encountered only a handful in our study, do not follow the stage path of internationalisation, but enter international markets soon after the firm’s inception - paying limited attention to the domestic market. New market conditions, technological advances in production, transportation and communication and increasing international experience of the founders are seen as key factors for the rise of this new breed of firms. This form of accelerated internationalisation frequently takes place in firms that produce highly specialised goods or services for niche markets.

Two contrasting case studies are provided to illustrate the two different internationalisation processes.

Case #86 can be considered an example of a BGB. A software development company that specialised in providing innovative solutions to the emergent services market. From the very early stage of the product development on it was clear that the
business could only be viable internationally as there was only one potential customer in New Zealand.

Right from the start of the operation it was clear that you would need to expand internationally because the market in New Zealand for your product wouldn’t be large enough. #86

Their current market focus is on North America and Europe. The respondent considered their product to be unique and they are currently ahead of the game compared to their competitors. They have successfully sold their product to the ‘early adopters’ with 50 implementations in eight countries and are now investing heavily in sales and marketing to increase their market share. They have subsidiaries in the US, UK and Australia and are thinking of establishing further subsidiaries in Canada, Germany and the Middle East. Subsidiaries are an important mechanism for the business, and although they are cost intensive, they are considered important to establish a presence in the market and to directly serve the requirements of the specific market. The subsidiary structure was also considered important to reduce risk for shareholders.

The subsidiary structure is to limit the risk on our shareholder base here. It’s basically to create layers that protect our holding company, that was the main reason for setting up the subsidiaries. But also it was seen as a marketing push, a sales push. If we’ve got a presence in those markets and if we are seen as a US company operating in a US market hopefully we get more traction quicker. #86

The subsidiaries have predominantly a sales focus with technical sales staff and business analysts, but all the development is done from New Zealand. The reason for focusing on North America, Canada and Europe first was because of the language and the reluctance to translate the software at an early stage. To follow this kind of internationalisation process, funding is a key issue and funding through revenue growth is usually not sufficient. Instead, they need to raise more capital.

We’ve even gone to the point of setting up an information memorandum to go out to prospective investors. [...] We’ve done capital raising a couple of years ago through two lots of capital raising. And they’re all very positive they know what we want to do and they all see it as great technology. It’s now about getting it in to those markets. #86

Case #46 can be considered an example of a staged approach. This concerned a manufacturer of natural health products including vitamin supplement, herbal and fruit teas and toothpaste. The firm has been established since the 1980s and employs about 50 staff. Exports account for 10% of sales predominantly to Australia, China and Taiwan. Exports were considered important and valuable to spread overheads and increase profitability. Main challenges were considered to be developing relationships with a degree of trust that enabled them to supply distributors.

Finding someone you can trust and building that relationship is important. You know we’re quite conservative in the way we do business We will pretty much want cash up front. #46

An example of an initiative that failed was discussed. The company had identified the UK as a potential target market of which there would be demand for their products. They went through the process of establishing a subsidiary company, but could not establish a distributor. It was seen as a relatively expensive mistake where the company invested thousands in British pounds, but ultimately was unsuccessful.
We saw an opportunity for our [product] in the UK. We couldn’t find the right partner to be a distributor for us, so we decided we would set up our own company, a virtual company, and fundamentally import the product into the UK through our own company. Trying to do that from here in New Zealand (we got some government assistance for that, an export grant), it was just so hard. You’re paying thousands of pounds for everything you want done. You want to employ a person, you have to get a lawyer to help you out with an employment contract, you have to have a chartered accounting firm to help you with paying that person, you have to have a chartered accountant to prepare your VAT return, your income tax return, all those things mentioned are easily a hundred thousand New Zealand dollar. By the time you’re finished, you’ve got to sell an awful lot of product to even break even. Tremendously difficult. #46

Overall, the perceived risks of developments and investment prevent faster expansion.

To go into other markets is expensive and dangerous process, it has been for us. #46

For example the respondent commented that they get a “lot of enquiries”, but these do not necessarily lead either to sales or to the development of export markets until they can build a trusting relationship.

We get a lot of enquiries [but], turning those enquiries into solid business with reliable partners is the trick, is the hard part. We’ll get a lot of enquiries from South East Asian people. I would even go so far as to say that every ten serious enquiries we get, we might convert them into one or two at the most, on-going reliable relationships that are valuable to us over time. #46

For this business, entering new markets is done very carefully and in a staged approach.

Are there any other markets? Definitely, but one step at a time. #46

5.4 Summary

It can be concluded that the decision to engage in international markets is triggered by a combination of factors that relate to nature of the market as well as the nature of the management. Having saturated the domestic market or receiving customer enquiries from overseas might not be enough for a business to start internationalising. It depends on the ability of the management to recognise and exploit these opportunities and ultimately commit resources towards building international markets. The decision to internationalise is the outcome of a dynamic process that in most companies takes time. Businesses internationalise normally from a strong domestic base and after establishing resources. In terms of the themes discussed in chapter 2, this favours a dynamic resource capability approach to understanding internationalisation behaviour.

A later chapter on the service sector businesses provides further evidence specifically for service sector firms in terms on the importance of these themes for businesses engaged in the service sector.

Compared to theories on the internationalisation process and our thematic framework, in practice evidence from the New Zealand companies in this study,
suggests that the predominant approach is very carefully managed in discrete stages.

Examples of internationally non-active businesses allowed us to identify an additional construct that moderated the relationship between triggers related to the market, triggers related to the management and the decision to internationalise: the nature of the product and/or service. Figure 3 serves to illustrate this relationship. It is important to note that internationalisation is only one possible strategy that businesses can pursue and it depends on the nature of the management and the nature of the product if internationalisation is considered to be the best option.

Figure 3: Understanding the internationalisation decision: forces that influence the strategic decision to internationalise
In this section we examine the nature and type of current internationalisation activities of NZ businesses in overseas markets. We examine the motivations behind strategic choices and why these patterns of activity have arisen in the context of strategic decision-making behaviour of companies. Internationalisation may involve a range of activities, including overseas sales through exports from New Zealand, licensing and contracting arrangements with an overseas partner, outward FDI (or ODI) through overseas operations that involve outward investment in capacity overseas either to outsource production and capacity or investments in subsidiaries abroad to establish a presence in offshore markets and to support sales. A later section in the chapter on service sector businesses (chapter 8) also considers the importance of outward FDI for firms in this sector. In this chapter we also include a section on participation in global value chains (GVCs).

### 6.1 Importance of Internationalisation Activities

First to help place the qualitative data in context, Figures 4 and 5 are compiled from the 2011 Statistics New Zealand BOS\(^3\) tables. Figure 4 is an indication of the relative prevalence of different international activities and the sources of income for those businesses that generate overseas income.

**Figure 4: Relative prevalence of source of overseas income indicated by activity**

(Source: Statistics New Zealand BOS 2011 Tables, Table 45)

Figure 5 illustrates the relative prevalence of different company strategies for generating overseas income employed by NZ businesses. The figure illustrates the importance of pre-existing networks or contacts as well as customised goods and

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services. The interview data from this study lent further weight to the importance of such pre-existing networks. The interview data revealed that networks and trusted relationships were an important determinant of a business’s ability to develop internationalisation activities. Opportunities to internationalise may arise through a combination of factors, however, it was important to have established networks and trusted relationships with contacts to exploit such opportunities. The importance of customised goods and services was also supported by our findings. Although there is an associated degree of complexity from one-off contracts to volume production, the interview data indicated that what seems to be important for manufacturing companies is the ability to invest in a strategic presence as well as ensure quality of supply. It is also apparent that the interaction between an overseas presence and overseas sources could lead to additional market opportunities for those in high value niche product areas.

Figure 5: Relative prevalence of strategies for generating overseas income
(Source: Statistics New Zealand BOS 2011 Tables, Table 57)

6.2 OUTWARD FOREIGN DIRECT INVESTMENT — ESTABLISHING SUBSIDIARIES TO EXPLOIT MARKETS

For the purposes of this report we define foreign direct investment as an investment that involves a commitment to a long term relationship, reflecting a lasting interest (Alfaro, et al 2004; UNCTAD, 2002). Outward foreign direct investment (ODI) can involve direct purchase of capacity overseas through outsourcing and location of capacity abroad. However, it can also involve developing an overseas market presence through a subsidiary operation. In this section we examine ODI as it relates to NZ-owned companies operating in overseas markets through subsidiaries.

Theoretically and in relation to our thematic framework, the establishment of a subsidiary company in an overseas market gives increased resource and dynamic capabilities and may have a number of subtle advantages, as overseas buyers may

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4 The key in Figure 2 for the second most prevalent strategy has been slightly altered from that in the BOS 2011 tables, the full description is: ‘Used pre-existing contacts and networks in overseas markets’.
more closely identify with a local company (as opposed to an overseas based company). It may represent a vehicle for a company that will more easily deal with local regulations and trading conditions, compared to operating from New Zealand. However, ODI is essentially a response to the need to invest strategically in markets overseas. It represents a long term investment and commitment which is undertaken even though there may be short term changes in economic conditions overseas, such as the continuing recessionary conditions in Europe. For example, case #20 is an example of a NZ owned medium sized company, involved in display equipment, which had chosen to invest strategically in European markets. This was an important platform for continued growth despite the continued economic recessionary conditions on Europe.

I think what was crucial was the move to a direct channel to market in Europe, through the creation of a subsidiary company, otherwise there was the potential risk that we'd probably might have lost the market. So creating a European presence was I think critical to that, it took 3 years of investment to get any real traction but now we are starting to see the fruits. All the local commentary today is that Europe is in some real trouble, and they are, but for us Europe is our biggest market despite all these tough times. #20

Another NZ-owned company, case #27, a high intensity exporter with 80% of income from exports, which was involved in manufacturing equipment in a niche agri-business sector, indicated that over a period of time they had decided to invest in a subsidiary in their major market overseas in Europe, the UK. Strategically this had proved to add additional advantages and was chosen because they could source local manufacturing technology.

We looked at different parts of Europe as well, but in the UK there’s some very good UK manufacturers and you’ve got a huge variety of sources of manufacturing technologies.. #27

A further example is provided from a respondent of a long established NZ owned large sized company, case #48, who over time were operating with subsidiaries in a number of overseas markets, but retaining manufacturing at its plant in New Zealand. They could be described as a firm with medium intensity in international activity accounting for 40% of their income. The respondent commented on their current operation.

We operate in basically 4 geographical areas, so we’ve got NZ, Australia, the UK and to some extent China. We’ve got legal entities in each of those countries and we also have a 5th legal entity in the US as well [……], but it’s not trading. #48

The respondent from this case indicated that, despite the legal entity in the US, they had not been successful as they were unable to establish their presence there. It could be that investment in a subsidiary is insufficient on its own, there needs to be an established presence almost as precursor to further investment in a subsidiary company. For example, case #27 had a long established market in the UK before the investment in the subsidiary, whereas the market base had not been established for case #48.

I think the reason why they’ve done that is entering into the market, to be able to enter a completely unknown brand in a country so far away with an agent it would be very difficult. That’s where we struggled in the US, we failed in the US we didn’t manage to do it. #48
It is worth comparing this experience with the section on ODI in the chapter on service sector firms (in chapter 8), there also ODI was undertaken strategically in response to market opportunities and the establishment of capabilities, but only after securing market presence.

The examples of ODI so far have been concerned with companies seeking a long term strategic presence and with important export markets accounting for a significant amount of their turnover. ODI may be undertaken for more short term reasons which are less concerned with the strategic development of a market, such as to provide a vehicle for more easily dealing with different rules and regulations in an overseas market. For example, with case #14, a medium intensity NZ owned company in the electronics sector, the respondent perceived such advantages from having an Australian subsidiary company and that this was perceived to avoid the existence of some barriers.

It's the Australian barriers that they put up though, despite CER that is the difficult one. If you tender [-----] for work into New South Wales or Victoria out of New Zealand, then because of CER they can't penalise us being a New Zealand company. They penalise all out of state companies because it isn't covered by CER. That's Australian politics and it's clearly there just to block New Zealand companies or to make it more difficult for us. It only affects New Zealand-based companies. Part of the advantage of being in Sydney is that we've managed to avoid that because we're selling from an Australian company. #14

It needs to be noted that under the Australia New Zealand Government Procurement Agreement (ANZGPA) all New Zealand suppliers must be treated the same as a firm domiciled in Australia, so that the view of the respondent was a perception of discrimination that should not apply and may have existed from a situation involving previous regulations (ANZGPA has existed since 1991).

It is noticeable that such examples existed for companies involved in the Australian market. It could simply provide a means to recoup expenditure such as that on GST and was a convenience vehicle. For example, with case #03, a medium sized NZ company which was involved in leisure development with an increasing proportion of their sales in Australia, the owner-manager commented.

The reason is that we had to contract local subcontractors to do insulation for flooring, electrical, site painting and air conditioning. Obviously we wouldn't be able to claim the GST back if we didn't have an entity there. So we had to subcontract these local entities in order to operate in that marketplace and be able to get a GST refund. We basically had to be registered in Australia. #03

Apart from administrative savings and ease of meeting local regulations, companies have an opportunity to develop a transfer pricing strategy; that is, deciding on transfer prices between a parent and a subsidiary. This was mentioned as a benefit in relation to a subsidiary operation in Australia by the respondent from case #04, a NZ owned large sized company with important, but low intensity exports in Australia in clothing manufacture.

It works extremely well; we have those two people who are employed by the Australian company, all the administration is done here. It is a very basic agreement, we have a strong transfer pricing agreement in place between the two countries which we do use outside consultants. We use [-----] because it has to be right and it does, it just all flows, it's a very simple structure over there. #04
It may take some time before a separate overseas operation is established, but this is the logical eventual outcome of an overseas presence, although to illustrate how models of operation can vary, case #05 concerns a New Zealand owned medium-sized company with medium intensity international activity in the mining engineering sector. As indicated by the respondent, the administrative work and project management is still based in New Zealand.

In time, as those opportunities developed, it became ultimately sensible to establish the [-----] Australian operation and employ some [-----] Australian employees and have that as the marketing and sales arm. Predominantly most of the support in design, project management, administration and services and even financial administration is all done from New Zealand. #05

To facilitate the development of international markets, we have seen that ODI can take a variety of forms. This varies from establishing an office that undertakes administrative and financial roles to much more advanced modes such as investment in a subsidiary operation that may involve production overseas. The more developed form of ODI takes an established market presence over time and represents a strategic response to commit long term to an overseas market irrespective of economic conditions. Those firms that had undertaken the more advanced form of ODI, tend to be longer established, but had been successful. With manufacturing companies seeking to operate in relatively distant markets such as Europe and North America there can be some obvious advantages. However, what is also apparent is that there does need to be some minimum scale and time involved to make such advanced ODI worthwhile.

6.3 Outward Foreign Direct Investment – Establishing Subsidiaries to Source Production

An alternative example of outward FDI (ODI) is where a company seeks to source the production of materials overseas and establish the operation of a subsidiary overseas. In this case the motive is one of reducing costs on the supply side of operations rather than the demand side. We have mentioned previously that there have been increasing pressures on NZ manufacturing businesses to source production overseas. We might expect these pressures to be higher in relatively labour intensive sectors such as clothing and textile manufacturing. This could involve both outsourcing via a strategic partner or via an overseas subsidiary.

Two examples are illustrative. The first concerns case #04 which is a NZ owned large sized company that is a long established garment manufacturer, with its main markets still in NZ and Australia. In terms of our thematic framework we can expect that trusted contacts and relationship will be important in establishing such an operation. In this case the company had established an important strategic partnership with a Chinese partner in order to outsource the production of its garments, enabling it to reduce the costs of operation in New Zealand, yet retain quality.

Because they have to, they carry the [-----] brand, so they have to be spot on. I know there was a lot of work put in to the factories and finding one which would come up to the quality that we required and also work with our quality controllers, because they go over probably once a month. #04

A second example is case #15, also in traditional textile manufacturing, long established and highly export intensive with 90% of their product going for export. Although a NZ subsidiary, they have still sought to reduce costs by sourcing part of the production overseas. Their semi-finished product is sent to Vietnam where there
is an established strategic partner company who complete the process by supplying labour, but the company has invested in machinery and an administrative team.

It’s all our machinery over there, but it’s in a company called [----] who supply the labour and process it for us. We’ve got a team of about four people over there that are employed by us who perform quality and administration work over there. #15

Case #15, however, could also be seen as a case of inward Foreign Direct Investment (FDI) from a corporate investor, often a global MNC which is headquartered and owned overseas. This is more likely with New Zealand companies, who may, like case #15, be part of a global value chain (GVCs). Separate sections follow on FDI and the emerging phenomenon of GVCs in this chapter. After these two further sections, we consider examples of NZ companies seeking to source raw materials and overseas purchases directly.

6.4 **INWARD FOREIGN DIRECT INVESTMENT (FDI)**

Much of the research on internationalisation behaviour of firms has focused on outward foreign direct investment (ODI). Until recently, less research has been undertaken on the impact of inward foreign direct investment (FDI) on firms and host countries (Garcia, Jin and Salomon, 2013; Scott-Kennel, 2013). Findings of positive effects of inward FDI on the productivity of local firms through a combination of competition and knowledge spillovers have contributed to the view that inward FDI can act as a catalyst for economic growth (Haskel et al., 2007, Keller and Yeaple, 2009). Recent research, however, has started to question this view by drawing the attention to the impact of inward FDI on innovation rather than productivity. It has been suggested that as a consequence of inward FDI, the ability of local firms to innovate on their own might be reduced which in turn might have detrimental effects on the long-term economic development of host countries (Garcia, Jin and Salomon, 2013).

Overall, there were 24 foreign owned companies in our sample. The following contrasting case studies illustrate some of the effects foreign direct investment can have on the internationalisation process of local firms.

Case #25 is a tannery with a long standing tradition in international markets. It is a very labour intensive production with relatively low margins. They were processing about three million skins a year in their New Zealand factory, had two wholly owned subsidiary plants in Australia and sales offices across the US and Europe which presented their largest markets. In the late 80’s the business was bought by a Japanese business to secure their source of raw material. Now they are processing only about 800k skins in New Zealand, with the remaining production being shifted to Vietnam. The respondent, the New Zealand manager, explained the move to Vietnam as follows.

At that stage of it, they just said this man here’s going to manage your business and [appointed] a manager in here who’d never had a business that was anything like this. In fact that was the first time that man had ever had anybody reporting to him and he was suddenly [appointed] to run a $60 million business. He did some sums on the back of an envelope and said we’re moving the finishing to Vietnam, so that’s how it went to Vietnam. #15

While moving the production to Vietnam reduced labour and shipping costs, the Vietnamese operation struggled to meet the standards set by their main customer – a global retail chain. The move of production was not the only change the new ownership brought with it. The new owners also decided to close down the Australian
subsidiaries and to take over and run the sales offices in the US and Europe themselves.

I mentioned we had sales office. About four years ago they suddenly said well we’re going to run this sales office. #15

At present, they are looking at moving the complete operation offshore. Options that are being explored are Vietnam or Myanmar.

Probably the biggest thing that we’re looking at, again this is driven by our [parent company], saying that they think we should move this complete operation offshore. [...] We actually question the wisdom of that, we think that might be chasing cheap wages, but cheap wages have a habit of disappearing and the other major advantage we’ve got here is that we’re on the doorstep of the raw material. #15

This case study illustrates some of the challenges associated with foreign owned operations. In this case, local autonomy was limited and the (internationalisation) strategy as well as decision making is strongly driven by the overseas parent company. Some of the respondent’s verbatim comments also point to cultural issues between the parent company and the local New Zealand operation.

Case #16 is a foreign owned company which breeds pasture seeds. They are exporting seeds to Australia, Chile and South Africa and the choice of export markets is determined by climate zones. All three countries have a similar temperate climate zone as New Zealand. Further they are contracted to breed seeds for their parent company and have an operation in Sydney. Export currently makes up about 30 per cent of their revenue. The overseas company has been involved as a minority shareholder since start-up in the late 80s and has continuously accumulated share until it gained 100 per cent control in the early 2000. In contrast to the previous case study, this firm has a high autonomy in relation to how the business is managed.

We’re definitely a New Zealand company, they have a high level involvement in our operations, but they don’t direct us in what we do. We’re run here and all of our management are here. #16

Right from start-up foreign investment was sought and considered crucial for their international strategy.

It was a deliberate attempt from day one to be international. #16

Being part of a large international holding provides the New Zealand business with access to markets and established distribution channels. Their parent company already had a strong presence in the markets that the New Zealand operation was interested in and they could capitalise on these existing relationships and on the market knowledge. Another benefit mentioned by the respondent was the knowledge spill overs that occur within the group. The New Zealand operation has got an extensive R&D program and is considered to be the ‘jewel in the crown’ within the wider international holding.

One of the big benefits of being part of an international group is that we have commonality in our research. If we want to develop some technology here, well, then we talk internationally first - A to see what’s been done and then - B to see what interest the others have in the programme and therefore what investment will they want to put in. If Ireland does some research, well we can pick up on it. Or if we do some research here, then the US might want it also. #16
The respondent was one of the few that we interviewed who had actually been involved with applications to the overseas investment office, to for example buy a 64 hectare block of land, and found it to be a ‘pretty straightforward process’.

Case #19 is part of a global group that produces computer networking equipment. The New Zealand operation which employs 120 staff is the largest R&D facility of the groups which has its headquarters in Japan. The business started out as a small local company, but was looking for foreign direct investment to raise capital as part of their internationalisation strategy. They were then bought by the current owners in 1999.

Before that it was New Zealand owned and the key reason for going international was to get capital. #19

It has since invested in a purpose built office and staff and this has helped the company grow which wouldn't have otherwise been possible. Having access to a worldwide sales structure through the holding is of particular benefit.

When they bought us, they poured money in to the place, these buildings were built, they increased the staff numbers quite a lot and poured money into development. So that was very, very helpful, we wouldn't have been able to expand like that, in any shape or form, without them. The other thing that we got that we wouldn't have had is access to the worldwide sales structure. So I don't how a New Zealand company would go about breaking into 80 countries worldwide for sales, but the way we did it was by being bought by a company that already had the sales structure. #19

While the New Zealand operation solely focuses on software design, the hardware is mainly designed in the US, manufacturing is done in Singapore, Malaysia, Indonesia and China and sales are worldwide. Overall, the international strategy of the New Zealand operation is completely driven by the parent company with only limited local input. Autonomy was limited to “how” they do it, but not “what” they do.

They are contracted to other companies within the holding to do joint development projects, e.g. collaboration with the US company who does the hardware component. Similarly, the New Zealand company contracts another Philippines based company that is part of the holding to do software testing for them. Testing is done in the Philippines for cost reasons, but the New Zealand operation had little input into choosing the location or company. Up until 3 years ago all testing was done in New Zealand, but the parent company decided to move it to the their Philippines based operation.

Basically what happens is that holdings will say create a switch that does this. Then [sister company] will do the hardware and we’ll do the software and we work together on that. So that’s one aspect. We cooperate with the Japanese development branch, they do some of the software for our products and they do a lot of testing and I’ll get to customer support. So there’s that, we collaborate with their development and test teams, we’ve got a test team that we contract to in the Philippines which is a direct contracting type of relationship. We provide their gear and their workload and they do the specified list of tests for us #19

The New Zealand operation is not directly involved in the sales, but the main markets for their products are Japan, Germany and France. They are strong in the Japanese market which the respondent puts down to the fact that they are Japanese owned.

They have two Japanese staff in New Zealand and at least one New Zealand staff in Japan as “on site connection points” and ensure that the different systems and processes interlink smoothly. Historically hardware and software development was done in New Zealand and a few other places around the world, but the parent company decided to have all hardware development done in the US now. Software
development remained in New Zealand because the operation had and still has the best R&D expertise and skill set available within the group. This provides an interesting contrast to case #15 who as a low value manufacturer had to move production overseas to reduce labour costs. In this case, high-value software development, labour costs in New Zealand are considered comparably cheap.

_When they bought us they saw no need to move the operation. From a Japanese point of view it’s not too bad a location because it’s in a reasonably convenient time zone and it’s not too far to travel. It has the advantages of being relatively cheap by Japanese standards without the disadvantages of corruption that some countries have._ #19

### 6.5 Participation in Global Value Chains

A number of companies were engaged in Global Value Chains (GVCs). Leaving aside service sector firms who are less likely to be involved in a supply chain, we could identify 16 cases that were involved in this phenomenon. Although a minority grouping, this is still significant despite New Zealand’s relatively low ratio of trade to GDP as reported by the OECD’s comparative paper (De Backer and Yamano, 2012). In most of these cases, the companies were subsidiaries of an MNC that operated globally and was the outcome of Foreign Direct Investment, where the parent company was seeking to secure supplies of raw material or a manufactured product that was part of a complex supply chain. The degree of complexity in the supply chain varied in each case, from relatively straightforward cases, such as in the forestry sector where wood and timber products may be exported to overseas manufacturers, to more complex cases, such as textile manufacturing, where a raw material may be exported, partly manufactured before being imported, for a further manufacturing stage and then re-exported. This variation is best illustrated through three brief case examples.

Case #19, a large sized computer equipment manufacturer. Owned by a Japanese MNC, the New Zealand subsidiary focused on software design, the hardware was mainly designed in the US, manufacturing was done in Singapore, Malaysia and Indonesia and China and sales are worldwide. Up until 3 years ago all testing was done in New Zealand, but the parent company decided to move it to the their Philippines based operation.

Case #29, a NZ subsidiary large sized company of a Canadian-owned MNC, processing natural gas to make its main product, methanol. This is used in a range of household and domestic products which are manufactured by affiliated companies downstream at plants in China, Korea and Japan.

Case #34, a NZ subsidiary large sized company, owned as a joint venture by two parent companies, involved in a traditional textile manufacturing, making merino yarn. The supply chain is complex, with NZ merino exported, semi-manufactured and then re-imported for manufacture in NZ by the company to make the merino yarn, which is then exported overseas for final manufacture with affiliated companies.

Due to the variation in complexity across the 16 cases that have been identified, it is not possible to identify issues or practices that are common across all such cases. However, it is worth noting that dynamically the pattern of manufacturing location could vary and change over time. This reflects the fact that, as in our examples, most of these cases are NZ subsidiaries and part of a global MNC that had ability to switch production and resources overseas, in some cases this was driven by the need to reduce costs or to respond to changing market conditions. It is clear in these cases, that such companies take strategic decisions on a global basis. For example with case #34, a decision to produce a manufactured product in Vietnam was taken with global operations in mind. The New Zealand subsidiary accounted for only about 10% of revenues for the whole group.
“We are going to think globally, so therefore it is not cost effective to do that in NZ, so let’s put it into Asia and let’s determine the best place to put it and, at the time, Vietnam was the choice. They made the decision to do that and during 2011 we got our investment licence from the Vietnamese authorities. We had done a lot of work before that and in December 2011 we had our first production.” #34

The location and production in New Zealand may have reflected securing natural resources. For example, in the production of timber, New Zealand was seen to have a natural advantage through the relatively fast growing radiata native pine. Where there was no natural advantage, such as in textile production, traditional manufacturing companies were still able to survive as part of a MNC through focusing on IP, as admitted by the previous respondent they were not able to compete on price.

“We can’t compete on price. We are more expensive, a lot more expensive, but what we can do is we can offer credit terms. We have a credibility in that the Anglo-Saxon background is that we say we will do something we will do it, we will stick buy it. We have a returns policy and if things are wrong you can return the fabric and we will stand by it. We will work it through and also we have knowledge and IP.” #34

GVCs cut across our thematic framework from Figure 1. Dynamically, over time, they can be the end product of a sequence of international behaviour and activity, but as such they may still be continually evolving. Individual companies involved, being owned by MNCs who are head quartered overseas, may have little influence on global strategic decision-making of the parent company, although they may still be able to retain some comparative advantage such as experience, knowledge or IP-related advantages.

6.6 Overseas Purchases

Where companies located their manufacturing in New Zealand, sourcing raw materials and purchases overseas was important for maintaining competitiveness and, hence, their ability to compete internationally. For example, with case #21, a NZ owned medium sized company involved in manufacturing in the agri-business sector, the respondent commented on the need to maintain competitiveness by sourcing directly their raw materials.

The biggest challenge is being able to source, for us, raw materials at competitive prices from the emerging markets, because there are just too many rogues out there in simple terms. You buy from a reputable firm in NZ you are paying their margin, their importer’s margin, the exporter’s margin in the country of origin and the factory margin for the factory that made it. Whereas we are trying to cut out the middle men, because it all comes down to competitiveness for us, because a lot of the raw materials that we input go into products that need to be competitive. ---- They are not made in NZ, they are products that will be imported, but have got all these individual margins all the way through, so we are trying to source directly out of factories in China and India. #21

This ability to able to reliably source the required quality of raw materials was also mentioned by the respondent from a traditional clothing and garment manufacturer, case #04, even though the production of the finished product was in China, but the company was able to draw on its historical knowledge base.

It’s the knowledge base and [knowing] the best way to do things. Sometimes you can be doing things because you’ve historically done them that way. We
import not only finished goods, but we import fabric into New Zealand. But we also import it directly into our factories overseas, so we will source fabric from Europe and we'll have to get it into China. #04

Purchasing overseas was affected by the volatility in the exchange rate in the same way that sales could be affected by the uncertainty of trading conditions. In theory, this could affect the competitive position of manufacturing companies operating in overseas markets. However, exposure to such effects was considered to have similar impacts on competitors. The following comments are illustrative from the respondent of case #14, an electronic switchboard manufacturing, NZ owned company.

On the import side we’re slightly luckier. The huge volatility obviously affects our costs, but, because there’s no core electrical product manufactured in New Zealand, all our key competitors - your [-----] and [-----] and [-----] of the world - they’re all importing from offshore too. If a movement affects us to the point that we have to do an unexpected price rise, then nine times out of ten the [-----] of this world have to do the same thing. So, we’re slightly insulated from the effects as an importer because all our competitors are exposed exactly the same. #14

Companies in high value manufacturing, or specialised niche technology-based production, have more scope to add value, utilising supply chain sources and remaining competitive in overseas markets, despite volatility and changing values in exchange rates. This is more difficult with low value manufacturing where there would be less scope to absorb sudden changes in sources of supply or via exchange rates.

Additional marketing opportunities could exist where a high value technology-based company could exploit its knowledge base and position in overseas markets from sourcing materials. For example, the respondent from case #05, a high value engineering equipment designer and manufacturer, commented on how the company had been able to develop additional opportunities from their niche market position in the Asia-Pacific region.

We’ve already started that process and, for example, a couple of product lines are very well known and established brands in Europe, but have no market presence in the Asia-Pacific region. So we’ve been able to secure that, we’re going to be their representative in the Asia-Pacific region and, whilst they might manufacture their proprietary equipment in Europe, Spain or Turkey, that equipment would come down and we would be the people that would install, commission and add peripheral equipment to that process. So those are the types of activities that we’re doing to grow and develop the business and provide a wider offering into additional market segments that we don’t currently cover, but are complementary to our equipment. #05

6.7 Overseas Sales

As might be expected the pattern and nature of sales in overseas markets was highly varied, from one-off orders and contracts to regular repeat and more volume-based business. A company might be able to rely on irregular contracts if their product could maintain a reputation. For example, with case #01, a medium sized NZ company involved in pharmaceutical products and research, the respondent commented on the stable nature of their product and market.

As far as I’m aware we haven’t changed it, it’s a stable market and it’s a stable product and we keep selling the same product over and over again. It’s
always the same product, its one product called [-----] which is [-----], a drug used to treat people addicted to opiate drugs like heroin to detoxify them. #01

By contrast, with case #16, a NZ subsidiary company in agricultural seed production, could rely on established contracts. The respondent commented on volume production and sales based on existing standing contracts.

We have contract production where we grow commercial volumes of seed in New Zealand for overseas. Primarily last year and this year, we’ve grown hundreds of tonnes of seed for the European market and from this year we’re the, I think we’re the only party that is growing contract seed for the European market for the [-----] group. #16

6.8 SUMMARY

The purpose of this section has been to outline the range and variety of patterns of internationalisation activity including overseas production, overseas sales and overseas purchasing. Each company will have varying experience, patterns and nature of sales. It is important to understand the tremendous variations in such patterns from one off contracts, ad-hoc sales to large volume driven producers with regular orders. Such variety and complexity may dictate different strategic approaches to overseas sales and production, but what seems to be important for manufacturing companies is the ability to invest in a strategic presence as well as to ensure quality of supply. It is also apparent that the interaction between an overseas presence and overseas sources could lead to additional market opportunities for those in high value niche product areas. A separate chapter on service sector firms also stresses similar factors.

A significant number of our companies were subsidiaries of large foreign owned MNCs and, as such, represented some of the impacts of FDI. FDI is an important phenomenon, we have shown that it may still allow autonomy, although the extent varies, but also give access to a wider global presence and resource. It can provide the foreign investment and capital that permits the development of an international strategy and lead to additional export markets.

A significant minority of companies were also in GVCs. These varied in complexity from relatively simple supply chains, exploiting natural resources in New Zealand such as radiata forests, gas and other natural resources to much more complex global supply chains involving manufacturing of imported materials and re-exporting semi-manufactured products. Being for the most part owned by MNCs, perhaps seeking to secure supplies globally, strategic decisions were taken globally, although NZ subsidiaries could still secure a niche reputation even within such complex GVCs.
Challenges businesses face in international markets have been widely researched and are therefore well known. The most frequently cited challenges include limited market knowledge, distance from markets, including psychic distance, as discussed earlier in chapter 2, risks from free market determined exchange rates, limited financial resources, different regulatory systems, language and cultural differences as well as increased competition in overseas markets. We explore some of these key challenges in more depth to explore variations between businesses. First, however, we illustrate the relative frequency of reported barriers to the participation in overseas markets and to the generation of overseas income for all New Zealand businesses from the Statistics New Zealand 2011 BOS data in Figure 6. This data indicates that for those businesses that currently generate overseas income, it is barriers associated with the exchange rate level and volatility that are the most frequently reported.

![Figure 6: Most frequently reported challenges for businesses that currently generate international income](Image)

Figure 6: Most frequently reported challenges for businesses that currently generate international income
(Source: Statistics New Zealand BOS 2011 Tables, Table 58)

7.1 Terms of trade and exchange rates

The issue of exchange rates is dealt with here as a challenge facing businesses, particularly since, in recent years, with the exception of Australia, the New Zealand dollar (NZD) has been appreciating against our major trading partners. However, theoretically this does not necessarily disadvantage exporting companies. This is because the change in the terms of trade can work in a company’s favour. Although the appreciation means that NZ exports become more expensive for overseas buyers

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5 For businesses that do not currently generate overseas income, but are interested in doing so, limited knowledge and limited experience are the most frequently reported barriers.
and hence potential reduced sales for companies that do export, it also means that, for companies that are able to maintain export sales, revenues will increase.

There are two aspects that could be perceived as a challenge for businesses; the appreciation against the US dollar (USD) and volatility, of which, the latter increases uncertainty when trading overseas. Figure 7 illustrates these two aspects historically.

![Figure 7: Historical Exchange Rate Movements 2002 to 2012](Source: NZFOREX historical exchange rates, quarterly data)

The extent of the exchange rate movements, over a relatively short period of time, was a factor that affected the stability of international sales and activities for a number of companies. For example, with case #01, a medium sized NZ biotechnology company, with exports to five main markets in Asia-Pacific, the respondent commented on this issue.

*Exchange rates have been probably the biggest thing we’ve noticed over the time period. When our dollar was strong, particularly for the Tahiti clients, it cost them more, so they were more and more reluctant, took longer to make decisions. --- I guess that’s been the biggest variable change is purely where the exchange rate is. In the six years I think we’ve done everything from about sixty cents or even lower to the USD.* 

#01

In some cases the appreciation of the NZD and the associated relatively high currency levels had affected trading of some companies in some overseas markets. This high level was more of an issue than volatility, but the pattern was variable. For example, a respondent from case #13, a specialist provider of software for gym management, with exports accounting for 33% of their turnover, commented.

*Because we sort it out so they don’t have to worry about the volatility, so it’s the level, the fact like it’s only just starting to slightly improve. A year ago we wouldn’t get any sales in America because our prices were too high because the NZ dollar was so strong, but now because their dollar has come down a little bit, I mean as in our dollar is coming down a little bit against the USD, sales are picking up there and we have to make sure that we are making money.* 

#13

### 7.1.1 Strategic Responses

The appreciation of the NZD ultimately places increased pressure on manufacturing companies to source production overseas as a way of controlling costs and increasing efficiency. This could be seen as a strategic response to the appreciation,
over time, of the NZD. For example, case #20, a high intensity exporter and manufacturer of agri-business equipment, was actively pursuing this strategy.

We are looking at the efficiencies that we can do here as a business, we are looking at where our sourcing options are, ultimately we are looking offshore and that’s what the impact of the exchange rate [appreciation] is doing. #20

Case #27, a manufacturer of mowing equipment found that there were significant advantages in producing overseas, in this case in the UK, which was one of their major markets.

We didn’t actually think we would get any variable cost savings from making a product over there, but as it turns out, we’re finding we’re getting 10% at least off our product cost. So we seem to be able to buy Sterling a bit cheaper, and a lot of the components we add to our machines come from Europe anyway, so (it avoids) bringing them in here and shipping them all the way back again. #27

In cases where sourcing production overseas was not feasible, such as timber processing, companies were forced to look at closure of facilities, such as sawmills that had become uneconomic to operate in the face of the appreciating exchange rate. For example, a respondent from case #40, a large NZ subsidiary of foreign owned MNC, commented on the closure of sawmill operations.

So now what’s happened with the New Zealand dollar and demand for timber, the prime sawmill was primarily a random width mill pruning our product going to the US, and with the fall in the US demand and the US dollar with the New Zealand dollar’s continual strength, that’s become uneconomic. We tried to run it for about a year on a reduced level and it was just burning through the money. Then in the South Island the [-----] sawmill, when we took over that, was in the throes of being closed anyway so we completed closing that. #40

In case #60, a NZ owned small sized company, in traditional hosiery manufacturing, had responded to the increased difficulty of trading conditions from the appreciating exchange rate by concentrating on the "Made in NZ" marketing caché.

It is tough, it was very tough, and we imported for a little time, but again the dollar going the way it did, our markets were becoming strangled because of that. So six years ago we changed things and we thought we had to change direction, so we decided to have a marketing push and become NZ made and really promote that quite strongly. NZ owned and NZ made and have a selective market audience. #60

Other companies, which were in multiple overseas markets, were able to offset margins in some economies where exchange rate movements created greater costs pressures. For example in the EU, with income from other areas, such as Australia. The comments from the following respondent from case #26, a NZ large company in multiple overseas markets, manufacturing food display equipment, are illustrative of this strategic response.

At the moment, because our biggest market is Australia, we don’t have an issue with the exchange rate, it’s been at 78, and we’re quite comfortable with that. Over in Europe, it’s a nightmare, obviously it was up to about the high 63s which is disastrous. The pound is over 50 again, it’s horrible, at the moment we just accept the fact, we will get lower profits out of Europe whether it be into the UK or into the EU. From our point of view we offset that because our biggest market at the moment is Australia and the Australian
currency rate is as good as it’s ever been for us. It’s certainly much less of an issue, it’s still the old story you get an order in from Europe and you sort of grizzle and then another one comes in from Australia and it makes you feel better. #26

One of the implications was that large projects based on primary production such as timber processing had become uneconomic. This is illustrated with the comments of the respondent from case #40, the NZ subsidiary company in timber production.

The biggest problem we have, and I’d say New Zealand industry has, is anyone looking to spend 100 million dollars on a big project like this isn’t going to do it. Because it’s just, you know exchange rate between 50 cents and 80 cents, it just kills it. You can’t operate a business unless it’s got big enough margins and these sorts of businesses, these primary businesses, don’t have big operating margins. #40

Volatility was something that was regarded as something to be expected from freely moving exchange rates. It was an issue that companies were affected by, but were able to manage, in some cases, from experience, by building in a margin that allowed for the expected volatility. In other cases by closely monitoring exchange movements and taking forward cover. An example of the former strategy is illustrated by the following comments from the respondent from case #01, a medium sized NZ owned bio-technology company.

We price in a margin to make sure it doesn’t move too much. We’ve never really been caught out, we’ve had to pay out what we quoted so we’ve never really lost in that respect. #01

Companies that operate with longer lead times or with lower value products and small margins, for example, with traditional manufacturing were more likely to take the latter strategy and seek forward cover and monitored exchange rates closely. For example, clothing manufacturers may be operating production well ahead of sales due to changes from seasonal demand. Three examples are given which are illustrative, the first from a respondent from a traditional clothing manufacturer with long lead times involved, case #04. The second example, case #34, is illustrative of some of the pressure on cash flow from long lead times and the third example, case #14, is from an electrical equipment and switchboard manufacturer.

We actually put contracts in place, we cover our foreign currency up to 18 months out because the showroom is currently full this week of people coming down to buy product for next winter. So we have to know what we’re selling that at. #04

The lower the exchange rate the more profitable we are because the yarn is 60% of the sale price and we get both sides in US dollars. From here to here takes about 4-5 months cash flow wise, so we pay for cash up if we purchase yarn we normally get some credit terms now, but historically we never had credit terms and we paid cash up front and months on the boat, a couple of months in the factory, a month to here and we could of give credit terms out here. Our cash flow is 4-5 months, everybody says 4 months but in reality it is 5. #34

From the exporting point of view, small fluctuations can kill your profit. The profit on, or the margin on [equipment], is not ridiculously huge so a small, unexpected movement there can have a significant effect. It can halve your profit or double your profit with not too much of a movement. Over the years,
we’ve done a lot of foreign exchange hedging and covering for a lot of that sort of thing but you can never fully cover yourself for it. That’s one that we’re constantly watching. #14

As mentioned, volatility adds to uncertainty, so even for some companies with Australia as a major market, volatility could still affect their confidence and attitude towards such export markets. For example, case #23, a components manufacturer supplying the electronic equipment sector still indicated that their major challenge lay in the level and volatility of the exchange rate.

Well the single biggest factor is the exchange rate. Well it is volatility that is the worst factor, but the absolute level is quite critical too. For us, we are lucky at the moment that our markets are Australia and the cross rate with the Aussie dollar is actually quite good. It’s at historically quite reasonable levels, so we are okay, but if we had a portion of our business in Asia now it is more likely to be in US dollars than it traditionally has been and that would be horrible with the US dollar rate the way it is, it would be very difficult for us. #23

7.1.2 Terms of Trade and Australia

A special comment is warranted on the trading advantages that NZ companies reported when operating in Australia as their only or major overseas market. To some extent the appreciation of the NZ dollar has merely matched the Australian dollar which has also appreciated particularly since the onset of the Global Financial Crisis (GFC), from September 2008. Of course, this means that companies exporting to Australia have not been affected by changes in the terms of trade, rather companies reliant on the Australian market reported that they enjoyed some cost advantages from producing in NZ and serving the Australian market, particularly with the cost of skilled labour. This served to give some companies a trading advantage even allowing for the additional freighting costs of shipping products across the Tasman. Comments from the respondent with case #03, a medium sized company and specialised manufacturer of fittings for new leisure developments are illustrative.

The simple fact is, it’s cheaper to make it here and that’s I guess on the internationalisation we have a pricing advantage and, so exporting to Australia makes sense. A dollar buys $1.25. We pay a cabinetmaker $25, they pay $30. Labour costs are significantly cheaper here. And then obviously material costs, we probably pay in New Zealand dollars what they pay in Australian dollars. Generally speaking $1 buys $1.25. We should be able to manufacture 25% cheaper than Australia. We’re focused on high end, high quality, so it’s got a little bit more margin in it. We lose 5-7% on sea freight and we lose 10% on air freight, so we can juggle either of those means of getting things to the market on time. #03

7.1.3 Summary

The appreciation of the exchange rate since 2008 has been a major challenge for companies, but some had adjusted and others were making strategic responses that involved cost reduction methods and sourcing alternative means of production. Manufacturing companies with long lead times were most affected, but were also involved in longer term adjustment strategies. High volatility of the exchange rate was also regarded as a major challenge, but the impact varies across different companies. As commented on by one of our respondents, from case #55, a small sized NZ company, but high intensity exporter, some manufacturing companies are able to protect their position through dealing in forward rates, but some don’t and may be vulnerable to high levels of volatility. It is the small manufacturing companies that are most vulnerable to such fluctuations.
That is the major problem that manufacturing has got. Most manufacturing companies here are on long term contracts with their distribution outlets so they’re stuck with the prices. Those who sell one-off are not so bad because they can spot quote on the price of the day. But covering, taking protection by way of buying forward or (hedging), the larger companies do, but the small/medium sized companies in the main don’t do that. Some will, when they’ve got a steady supply situation. #55

7.2 Funding and Liquidity Issues

Complementary and related issues to that of the appreciation of the exchange rate and especially the high volatility are funding and liquidity. We have indicated previously that triggers to enter overseas markets may lead to decisions to invest in a sales team overseas or to undertake a marketing campaign; obviously these require resources and investment. For example, even when exporting to Australia it will still be necessary to undertake investment and arrange credit facilities. We have also indicated previously that long lead times, particularly for manufacturing companies, will also require investment and will place additional pressures on, or constrain resources.

For example, with case #27, a high intensity exporter and manufacturer of high quality mowing equipment with the main market overseas being the UK, the respondent commented on this challenge.

The very least is six weeks of shipping really, and sometimes it goes out as far as seven to eight weeks so we are having to, we’ve done it for years but there’s a lot of inventory sitting on the water for a lengthy period of time (and). The cash cycle really in the UK can be five to six months, by the time you’re holding stock there for a month or two, then get your cash from your customer, it’s a long period of time to be waiting for money to come in. #27

And the same respondent was able to comment later on how this was a constraint on the resources of the company when seeking to undertake a marketing campaign.

We haven’t been overly profitable for the last three years, short of cash so we’re constrained in what we can do and a big part of this UK project is to try and free up some of that cash so that we can start to reinvest that in business. #27

In some cases, long lead times can be exacerbated by the irregularity of orders which add to the liquidity and cash flow problems. This was commented on by a respondent from case #40, a subsidiary of a foreign owned MNC company with high intensity of exports in timber and forest products.

Well that’s the problem, there’s a lack of options for these guys that are trying to fill a ship. And the thing is in terms of it you have a ship call once a month and you fill it, which is fine, but you end up with massive cash flow issues. #40

In establishing credit lines to facilitate international activity, a good relationship with the company’s bank could be regarded as critical in helping a company meet the challenge of long lead times and related cash flow and liquidity issues. The same respondent indicated the importance of a good long term relationship with the company’s bank.

We’ve had a very long term relationship with [-----] which has been really good and it’s quite a cyclical business so they’re aware of that. #40
Larger projects may have longer lead times before payment. For example, with case #03, a NZ company that enjoyed recent rapid growth in its main market in Australia, concerned with the fittings for the retail and leisure sector had experienced payment terms that had lengthened as their involvement in larger projects had grown.

Now, as time’s gone by the contracts have got bigger and therefore dealing with larger contracts in Australia, all construction contracts have now moved to a minimum of 45 payment day terms. So, that means your carrying cost is quite high and generally you’re not getting paid… not for 60 days. #03

Apart from the investment required to establish a presence in an overseas market, even in an overseas market like Australia, this can still mean establishing an overseas bank account, undertaking a registration process which can be a further challenge. The respondent, from case #13 had found it was easier to overcome such issues with a personal bank account.

We thought well we will open up a bank account in Australia so that they can just treat us like any other Australian trader and to do that we would have had to register the company in Australia. So once again the related costs of trying to do that discouraged us, but it’s quite simple for me as an individual to open a bank account in Australia, so that’s what we’ve done. They put it into my individual bank account, which is on our company books and so forth, so it’s all recorded, it just happens to be in my individual name because that was the easiest way to do it and we just bring the money back, and as I say it’s all recorded and everything, taxes are all paid. #13

Like the previous example, companies demonstrated very resourceful ways of overcoming the liquidity and cash flow issues from internationalisation activities. These did not significantly prevent opportunities from being exploited, but did put pressure on internal resources and financial capital. This reinforces the importance of dynamic capabilities identified in our thematic framework. In the longer term, such issues also contributed to the longer term strategic responses which have been mentioned in the previous section.

7.3 COST, TIME AND AVAILABILITY OF FREIGHT

Given New Zealand’s distance from other major markets, freight is obviously an issue that is important for manufacturing businesses operating overseas. While the cost of freight was mentioned most frequently, issues of time and availability were also mentioned.

For most of the manufacturers that we have interviewed sea freight was their preferred delivery mode with air freight only used in exceptional circumstances. While respondents considered freight generally as being increasingly costly, it didn’t necessarily have a negative effect on the business. For example, with case #03, a highly specialised manufacturer of fitting products for the up-market retail and leisure facilities in Australia, the client is absorbing all freight costs – if necessary even for air freight. The business has a preferred supplier arrangement and because of its strong position in the market and the high value of the product, as commented by the respondent, the freight costs do not negatively impact on the business.

They’re absorbing the air freight costs themselves to get it there in time. #03

For other manufacturers, however, freight costs limit their expansion into new markets. This is particularly the case for low value manufactures, such as case #51, a medium sized NZ owned fruit and vegetable grower, high intensity exporter that sells its frozen produce to Australia. The respondent commented on the limitations.
It restricts us to Australia really because once we get further afield than Australia the freight kills it. #51

Depending on the nature of the product, the limits to business expansion are individually different i.e. for some it might be Australia and the Pacific region, for others it’s further afield into Asia.

If the cost of freight is perceived as a challenge, this does not only depend on the relative strength the business has in the market and the value of the product, but also on the sales volume. An example is case #32, a niche producer of injected moulding plastics products for the marine industry. Because of their small sales volumes into Europe, they are restricted to air freight which makes up 15 per cent of the total costs. While these costs are partly absorbed by the client because of the highly specialised nature of the product, a reduction in freight cost would improve the competitiveness of the business. This business is now exploring the setting up of a storage and distribution facility in Europe. To justify this investment they are trying to increase sales volumes to be able to send container loads to Europe.

Well it’s a huge improvement in efficiency for both our clients and for us because then the freight costs would probably be half. #32

For some businesses, it was less about the cost of freight, but more importantly the time it takes to freight their product to the overseas destination. To ship a product into Europe it takes at least four weeks which makes them less flexible compared with local suppliers. In trying to stay competitive and overcome this challenge businesses were forced to change and adapt their production process to become more efficient. While in some cases this has meant changing the production process in New Zealand by for example introducing lean management, in other cases the solution was to explore options for overseas production.

One example is case #26, a NZ owned large sized company and manufacturer of customised food display and storage units whose main market is in Europe. The customised nature of the product does not allow them to carry any stock, but instead they need to produce by order. Their major European competitors have got eight weeks manufacturing lead time. In order to stay competitive, the business needs to manufacture the product in three weeks to allow enough time for shipping.

Our European competition has an eight week manufacturing lead time. Our way to counter that is that we have a three week manufacturing lead time from the receipt of order, so by the time we put it on a boat and get it there we actually still get it there before their local suppliers have manufactured it. #26

Another example is case #27 a NZ owned small sized company and manufacturer of specialised mowing equipment whose major market is in the UK. Up until recently all products were made in New Zealand, but allowing for shipping times, it takes six months from order to delivery, a long period to finance credit. Two to three years ago a decision was made to invest in a production facility in the UK to shorten the supply chain and increase profitability.

It’s probably been a two to three year project to move some of our production from New Zealand to the UK. #27

Lastly, for some respondents, the availability of freight was considered a challenge. With ports in New Zealand reducing their shipping, those businesses were faced with fewer options to serve their overseas markets. An example is case #40, a foreign owned NZ large company and manufacturer of wood pulp whose main market is in
Indonesia and China. Particularly for Indonesia, freight connections have been reduced.

*Indonesia is a problem in terms of getting shipping lines from here. Over the years the options out of Wellington have been reducing. So as an exporter your options out of there are reducing.* #40

The limitations were also referred to by the respondent from case #44, a small sized company, but NZ owned and in food manufacturing producing to contracts from large fast food chains.

*The increase in fuel prices has meant that shipping companies are now slowing down their ships to conserve fuel and so the transit times are increasing. Our product has a specified shelf life which means that it obviously affects the use by date. If there’s increased shipping times, it is reduced in the country of destination — so it’s the flexibility, turnaround time and that to a certain degree mitigates the disadvantage of our geographical isolation.* #44

### 7.4 Marketing Overseas

The very nature of marketing overseas places greater pressure on resources of the company and particularly the time of the CEO or entrepreneur. Customers will often want to see the owner or CEO when agreeing contracts, frequently requiring the establishment of a team which requires up-front investment in resources. Even when the overseas market is a relatively near location, such as Australia, this can still be a big commitment or challenge for the entrepreneur. For example, case #05 is illustrative of a technology-based small company that was involved in specialised and high value mining engineering and associated project management.

*We had to spend some time in the marketplace, so over the last five or six years I’d lost count of times how many times I’ve been across the Tasman because I just spend so much time in the marketplace there. Now that we’ve got established marketing and sales staff over there there’s less requirement for that, but still often they want to see the CEO or talk to the CEO when it comes to the final negotiations.* #05

We can expect that such challenges would increase with distance, although this was not necessarily the case for all the up-front marketing expenses. For example, case #13, a NZ owned small sized company involved in software for exercise equipment, the respondent indicated that in Australia, their current major overseas market, it could be relatively expensive to undertake advertising campaigns and undertake a promotional campaign compared to alternative overseas markets.

*In terms of advertising and promotion it’s not ideal because it’s more expensive than say for us to go to America and that’s even when you take into account flights and accommodation. It’s very expensive to advertise and promote there [in Australia], but at the same time when we do the installs we contract out because it’s cheaper in that respect.* #13

However, in some cases the main challenge was the up-front investment and ‘sunk’ costs associated with establishing a company presence in an overseas market from which to undertake marketing and associated sales promotions and campaigns. For example, with case #14, a large sized NZ company and switchboard manufacturing company the respondent commented on the cost of marketing in Australia, also their largest market.
Probably the most significant thing is just the sheer cost of doing that marketing over there as well comes into the equation. We’ve found that overall it’s been more effective to focus on building the one-on-one side, identifying those that have got an opportunity to use our product and then working that one through with them, but it takes a while. #14

Further the respondent indicated that there was also a need to educate the market and in some respects this could be seen as a bigger challenge:

It’s about convincing them or teaching them a different way of doing things. For us that education is probably more of a challenge than the actual sale itself. #14

Overall, to be successful and to exploit opportunities in overseas markets, a major challenge for many companies is the up-front investment required to provide a sufficiently large enough presence through staff and other facilities. Like the forces that influence strategic decisions to internationalise, this would be influenced by the nature of the product or service. In some cases this might be limited to the increased time required to be spent in an overseas location, in other cases it might require considerable investment in resources to undertake a marketing campaign ahead of realised sales.

One challenge that is perhaps under-reported is the need to educate the market, which could be seen as requiring additional time and resources. This factor is likely to increase in importance when considering high value manufacturing and technology-based companies.

7.5 DUTIES AND TARIFFS

Duties and tariffs levied in overseas markets is a further factor that increases the cost of sales and promotion in overseas markets and it could be argued is a significant challenge for some companies for some overseas markets. For example, some of the Pacific islands provided the potential for overseas income that was affected by import tariffs. A respondent from case #08 a small, owner-managed company involved in screen printing with customers in Fiji had examined the potential for avoiding import duties by sourcing production there, but had found that such a process was not justifiable in order to maintain quality.

They've had some cowboys' up there and they try to get up there, the import duty is horrendous in Fiji, it’s 27% on everything and then you’ve got the Fiji dollar it’s less than ours, so they have tried to produce up there but the quality’s just no good. #08

In some cases and in some overseas markets import duties and tariffs were accepted and were regarded as something that was part of the process of internationalisation and could be overcome, in other cases there were examples of companies that had decided to reduce or cease to trade in some overseas economies and, in other cases, had been discouraged by disincentive effects of duties and tariffs. A broad generalisation is that the disincentive effects of import duties overseas tended to be more significant with developing rather than developed economies. For example, the comments on this issue of import duties in overseas markets are provided from two respondents from different companies, but both involved in manufacturing in the agricultural produce sector which are illustrative. The first, from case #20, a high intensity exporter and manufacturer of processing equipment for agricultural produce and case #21 also high intensity exporter and manufacturer of a diverse range of products in agriculture and aquaculture.
In some markets, in the South American market. So just working out how we get around those sorts of things, it’s not so much an issue in Europe or Australia or the Americas it’s more in South America and those developing markets. #20

The challenges that are added to that are tariff, some markets still have tariffs, we are trying to get into South Africa at the moment and there is no tariffs from [-----] out of Europe but there’s tariffs from [-----] out of NZ into South Africa. #21

There were indications that the existence of import duties, in some overseas economies and for some companies, restricted the potential of internationalisation and hence overseas income. As an inhibiting factor, such duties could be reduced through the continued move towards free trade agreements (FTAs) with individual overseas nations or with trading ‘blocks’ of nations. For example, the respondent from case #37, a large sized subsidiary of a foreign owned MNC in the food packing and produce sector, commented that the company had the potential to significantly increase their sales in Japan and Korea if progress could be made on FTAs with these economies.

I’m not holding my breath, because I know how difficult getting an FTA with Japan and Korea in particular would be, but we’re confident that in Japan could easily double or triple our business there. We’re doing about 20,000 tonnes at the moment and we could easily that up to 60,000 if we were to eliminate tariffs. #37

Overall the nature and importance of overseas import duties and tariffs as a challenge should not be over stated, as we have seen it was significant for some companies and for some overseas economies. Given that many companies were dependent on Australia as an overseas market, with the progress through Closer Economic Relations (CER), for many import duties and tariffs did not figure as an important barrier.

7.6 Compliance with Regulatory Systems and Processes

Companies that export products overseas have to comply with regulations that may vary for each overseas market. The nature of this issue varied across different companies, but it was important for number of technology-based and high value manufacturing companies. For example, a respondent from case #26, a large sized NZ company and manufacturer of food display units, commented on the importance of compliance with regulation.

Trade barriers, if we look at Europe, the duty rate is 2%, so it’s not crippling by any stretch of the imagination so we don’t really need to worry about that one. Australia, obviously we’ve got CER, so we don’t worry about that one either. It really hasn’t come up a lot, we face different trade barriers than just duty. Our number one trade barrier is compliance, because we make an electrical product, but unfortunately it’s a customised electrical product that potentially changes week to week and that can become difficult in certain markets that require stronger global compliance and we lead the field, so quite often if, for instance you are looking to get a UL compliance to get into America or something like that, the product itself has to be certified and so do all components. #26

Compliance with overseas regulations adds to the challenge of complexity for exporting companies. Therefore, as these vary from economy to economy the potential for complexity increases with the number of overseas markets. The issue of
complexity generated by overseas regulations may be reduced through adoption of internationally recognised standards. For example, with case #37 a large sized NZ subsidiary of a foreign owned MNC in food and beverages, the respondent commented on such potential.

If we can overcome those issues and get people aligned to one standard, then that takes a lot of complexity out of our company. We export to 40 different countries so each of those countries and for each of the products that we send we need to have a completely different set up. #37

For some companies, in niche markets, the nature of compliance with overseas regulation could be a complex and important issue, even if they were involved with only one overseas market such as Australia. For example, a respondent from case #54, a company that specialised in the export of semen in the equine racing industry to the sector in Australia, commented that regulations were becoming more difficult to meet and were changing which added to the costs and complexity that they were facing.

The biggest issue is a quarantine one, and we find MAF and AQIS quite difficult in a lot of ways, and that’s the one that scares me the most because it’s getting tougher and tougher. The rules are getting tougher in what you have to do and, like last year, MAF pushed us into a corner that we had to do testing on our stallions. That had already been done in quarantine when they come into the country and it cost $9,000 to do the testing and you have ridiculous things like from AQIS’s point of view, they changed the protocol, the working in the protocol for what the horses have to do to meet their quarantine rules. #54

The findings indicate that compliance with overseas regulations is probably an under reported issue in terms of its importance for exporters. This issue could apply equally even with Australia where CER might lead one to expect closer harmonisation (of regulations), but as commented by the respondent from case #01, a medium sized bio-technology company, there is a need to for companies to be aware of different approaches and regulations.

Whereas Medsafe will say I think you need to do this, or you need to do that and although we may not always agree, they’re a lot more willing to be pro-active, so I think Medsafe’s been a lot simpler, but the lessons we’ve learnt to answer your question is that we need to make sure that we’re very clear with that. Black and white and by working through Medsafe’s issues, then we can largely streamline that into Australia and go into Australia where it’s a lot more black and white. #01

7.7 Staffing Issues
Here the focus is on the extent to which the recruitment of key staff is a challenge for entering and becoming established in overseas markets. Operating in overseas markets requires either a reliable agent or local staff who may need to be recruited from overseas or re-located from elsewhere. For example, exporting to Australia may require the establishment and presence of a local office and sales team. These requirements were illustrated by the comments from the respondent from case #03.

We’ve struggled to find good people and have found that being at arm’s length without having self-motivated individuals makes it difficult. That’s been difficult not having an office with ten people where everyone’s coming there each day because we’ve got things happening in different states, small office, two people. So, not having that critical mass there, finding somebody who
would drive that business forward in each of those markets has been very, very difficult to find. #03

The alternative strategy of operating through sales agents could prove equally problematic as finding and establishing good reliable agents proved to be an issue for the following respondent from case #08, a small NZ company and specialist niche provider in screen printing.

We would like to get some more agents, but you’ve got to get the right person. If you get the wrong person you just don’t you know, I mean really all of our sales people here and in Australia, are fifty five plus, we don’t seem to have the young ones because you can’t keep a tab on them. #08

For some companies, having the right person dedicated to international development and overseas sales, perhaps willing to spend time travelling overseas, was important to exploit potential overseas markets. The following comments by a respondent from case #14, a large NZ company in manufacturing of electronic equipment switchboards are illustrative.

What we’re lacking at the moment is any formal salesperson that particularly focuses on that offshore market. For us at the moment, I hate to say it’s probably a bit more of an ad hoc thing, as in we do a lot of work, but we’re not really putting as much effort into finding that work perhaps as we should be or could be. We’re working on fixing that at the moment. #14

[And] the only other major barriers really are just us resourcing ourselves to have someone out there full time seeking those opportunities and bringing them back. We know they’re there, we know that we’re cost effective, but it’s just someone being out there full time focused on it. #14

Recruitment of skilled staff locally in New Zealand was an issue that was reported by a number of companies. At a managerial level, this could require a search procedure before someone of the right calibre could be found. The following comment by a respondent from case #20, a high intensity exporter and manufacturing of agri-business equipment is relevant.

If you go back to the story about manufacturing in NZ, as it’s being squeezed and more and more of it is moving offshore and there is less and less of it here, there is actually less manufacturing management expertise to actually run it and so, therefore, what does that look like in another 5/10 years from now? If there is little or none, finding someone to manage the manufacturing will become more and more difficult. We spent 12 -18 months trying to recruit a manufacturing manager. #20

The company concerned did eventually recruit the calibre of manager they were looking for, but the search time required is revealing in terms of the challenges that manufacturing companies in New Zealand can face when recruiting skilled and professional staff.

7.8 Non-engagement

We have noted that our sample included 28 firms who were not internationally active, although a small number were actively considering overseas markets and were seeking information and contacts that would lead to an initial presence. In this chapter we have discussed a number of challenges that NZ businesses are facing that are internationally active. For those companies that were non-active, these challenges were significant enough to prevent international activity, but in addition
other factors were identified including a lack of appropriate contacts and networks, concern with maintaining reputation, a focus on local markets and entrepreneurial orientation. These factors are discussed below, with illustrations from selected case examples.

- Funding issues

Funding issues were factors that featured in our discussion earlier in this chapter. For non-active companies, they were not discussed as an area directly of concern since strategies were often concerned with maintaining relationships in local and domestic markets. However, with case #17, an engineering company concerned with maintenance support, the manager commented on a lack of long term investment that affected the possibility of international activity.

The owner obviously put an initial amount of cash in to the business when he bought it and then he slowly drew that out and since then we funded any development purchases all out of cash flow [which affected activity]. #17

- Cost, time and availability of freight

This was a factor that affected case #72, a provider of pre-cast concrete to the building industry. Although there had been some involvement seven years ago with a contract in the Pacific Islands, they found that their requirements to be close to site and the cost of freight prevented any further overseas activity.

Difficult to transport because it’s all sorts of sizes and all sorts of connection details, bars coming in and out. #72

- Staffing issues

Finding skilled labour which would facilitate the internationalisation process was a factor that was considered as well for case #17.

So to go overseas or grow the company you’ve got to be reliant on getting skilled staff and just support the quality of work that you, and doing it in a timely fashion. #17

- Confined to local markets

Companies can be constrained by being confined to local or regional markets and operate on too small a scale to be capable of entering overseas markets. For example, with case #80, a supplier of specialised garden paving stone and, although having successfully grown the company to the present operation with 20 staff, but they considered that the local market still provided potential, which combined with freighting cost meant they were confined to a regional market in the South Island.

It becomes relatively expensive once you start to move away, even to the North Island, we send a little bit up to the North [Island]. #80

- Overseas regulations

Overseas regulations have been discussed as a challenge through compliance issues. They may act to prevent or delay entry into overseas markets. This factor can be illustrated with case #76, a company that had developed a timber related product designed to operate in the NZ environment and were actively considering overseas markets, but needed to develop the product to meet overseas regulations.

And that has the, certainly has export potential we believe in to North America and British Columbia and Canada and possibly in to a couple of states in Australia. But that’s, that’s still in it’s what do you call it development stage.[- -] Compliance yes, there is going to be huge compliance. #76

- Need to establish contacts and networks
This factor is illustrated with case 77, a company that provided professional career advice, education and training services. Based in the South Island, the owner had been concerned to develop local markets, particularly in Christchurch and other localities, but was now actively considering Australia as an overseas market. However, the owner commented on the plans to attend a conference in Sydney to establish contacts and networks as a precursor of international activity.

“I've got colleagues obviously in Australia and Australia runs a conference every year, next year is Sydney. And myself and my manager from [-----] are going to go over. #77

- Concern with quality and safeguarding reputation

A company may wish to control quality and its reputation which can be more easily achieved within local markets. For example, with case #24, which was a company in the adventure tourism sector and although earning overseas sales indirectly (via overseas travel agents), had withdrawn from participating in outward FDI because of a concern with quality and reputation.

*It does carry some risk for us from a branding perspective, if something goes wrong, because it still carries the [--------] branding.* #24

- Serving a local market with the need for close relationships

Case #82 concerned a professional law company and although the company did undertake occasional work for an overseas client, the focus was on serving local clients where personal and close relationships were important.

*This is not something that is proactively pursued by the company, but if a client is from overseas and concerned with a civil legal action, then the company will do it.* #82

- Entrepreneurial orientation and motivation

A lack of entrepreneurial orientation through a focus on local markets rather than ambitions to seek overseas markets has already been discussed in this section with case #17. A further example is provided with case #84, a company that was involved in providing specialised heating cylinders. The manager commented on the focus on local markets and again the need to be close to customers to be able to respond quickly.

* Basically it's just been local, locally produced product and being able to supply at short notice into the South Island anyway, so it’s all about service in that case, service and product quality.* #84

- Summary and comment

It is important to realise that these factors are *indicative* of the reasons that prevent internationally non-active businesses from participation in overseas markets. The sample of non-active businesses for the purposes of this study was effectively a convenience sample and is unlikely to be representative, hence it would not be appropriate to generalise on the importance of these factors. To make comparisons with active businesses, it would be necessary to have a matched pairs sample so that valid comparisons of behaviour with active and non-active businesses could be drawn.

With these riders in mind, however, it was noticeable that there were examples of well managed and successful businesses that had thought carefully about entering overseas markets and decided against such activity because of a lack of trusted contacts and networks and the recognition of the long term investment requirements, rather than other factors such as a failure to compute the long term costs and
benefits. Where there was some similarity in businesses and sector, it was clear that entrepreneurial orientation and motivation was an explanatory factor. For example, with cases #03 and #65, active and non-active respectively, both were involved in joinery related fittings in the construction sector, but were very different in ambition. The objectives of the respondents (both owners) were contrasting; case #03 was focused on growth to increase the value of the business, whereas case #65 was concerned with a focus on local markets, keeping costs down and business survival.

In the first couple of years we went from zero to doing about $3-4 million of joinery exporting per year. It sort of just went from zero to $3 million in a very short timeframe. Now this year we’ll probably end up by doing I’d envisage well over twentyish maybe. We started off by targeting a variety of parties in Australia who we thought would be strategic partners. Ultimately for me it was actually looking for somebody who would buy us, that’s really what it was targeted for and at the same time somebody who could bring us work. #03

Just at the moment the whole idea is to stay in business, keep my boys employed here as much as they can be. I would like to go to the moon, but if I can’t then I can’t - I stop dreaming about it. #65
In this chapter, the themes discussed have been identified from the 38 second stage interviews targeted exclusively with service sector companies. These interviews involved 20 businesses who were listed as active internationally and 18 listed with no international activity. There are also a number of companies, 22, from the stage 1 interviews that could be classified in the service sector. A small number of companies from stage 2 were also involved in manufacturing, although having associated support services. For this chapter we draw more heavily on the second stage interviews.

Much of the theory of internationalisation of businesses is based upon manufacturing firms (Altinay and Roper, 2007). The service sector is very diverse and includes, for example, businesses operating in professional services, tourism and education. Examples of firms from all of these sub-sectors were represented in our sample. Because of this diversity, generalising across the sector needs to be treated with caution, but it has been suggested that personal networks are critical for internationalisation to be achieved and are more important for service sector firms than manufacturers. For example, Lindsay et al (2003, p. 25) in a study of five service sector firms from the US and from Scandinavia develop a conceptual model in which personal relationships are critical to knowledge transfer. They indicate that “The role of particular individuals in relationship development, knowledge flows and learning, features strongly in all of the cases”. The role of personal and social relationships was also highlighted by a study by Riedhlen and Apel (2007, p. 142) with internationalised firms in professional services (PSFs). They comment that the nature of such relationships can determine the competitive edge for internationalisation: “For gaining and sustaining competitive advantages, these characteristics imply that strategies of PSFs mainly emerge from managing intellectual capital embedded in social exchange relationships with clients, peers, educators, and professional associations.”

Prior research with New Zealand service sector firms has also indicated the greater importance of networks and personal relationships with these firms. For example, Chetty and Stangl (2009, p. 1740) in a study of ten SMEs in the software industry found that network relationships were influential in internationalisation activities and sustainability and that: “Firms with a radical innovation and diverse network relationships are more likely to have radical internationalisation.” That is, the more diverse the network the faster the rate of internationalisation of the firm’s activities. Scott-Kennel (2013, p. 122) in a study of 30 New Zealand businesses involved in international activities found that with a group from the service sector, although typically targeting English-speaking countries, they were increasingly drawn to Asian markets because of “abundant opportunities”.

It is well known that manufacturing firms in New Zealand face pressures to reduce costs to remain competitive in international markets. As we have noted, service sector firms place greater value on networks, social and personal relationships which can determine their competitive advantage in overseas markets, stemming from their knowledge base. As noted in a recent paper by Scott-Kennel (2013 p. 114): “Service firms, by the nature of their offerings and the need to locate close to customers, often employ exporting in conjunction with network or partnership-based modes of entry.” The greater emphasis on personal relationships compared to manufacturing firms means that it can be more likely that service sector firms will operate from an administrative base in New Zealand. Scott-Kennel (2013 p. 114) in a review of sector differences in the internationalisation process comments “In many cases services are
still provided from a New Zealand base, but marketing and customers are international.”

In theory then, businesses in the service sector will rely more closely on personal relationships with customers than businesses in manufacturing. Their competitive advantages can be expected to lie in the quality of service. Their ability to attract clients from overseas markets will be through either a uniqueness or difference in their service or an ability to provide a better quality of service than competitors. We can expect some challenges to be less important such as distance and the appreciation of the exchange rate. However, other challenges may be more important such as different cultures and regulatory regimes.

8.1 Export Markets

The important markets for international activity were focused on countries that were culturally similar, or had similar business systems, to New Zealand and included Australia, UK and Canada. Although even between these countries there were perceived differences and experiences. International clients were located in markets in which there were similarities to the New Zealand market, perhaps through business practices, cultures and ways of working and in markets in which they could operate similar business models. In these respects the UK could be more important than Australia. For example, this is reflected in the comments of a respondent with a New Zealand owned group of companies delivering a mental and disability care service, case #100. This organisation developed a specialised software product that had more potential in the UK than Australia because the model of delivery of such care services, based on community care, was similar to the model in New Zealand.

It’s actually growing faster in the UK than it is in Australia because the UK are much more aligned with the system of service delivery that we have in NZ. Australia is quite far behind so we talk about supported work. #100

Countries that had similar environmental conditions could also be important. For example, case #76, a company that had developed a service to meet the needs of the forestry sector in New Zealand were looking for similar markets overseas, in this example, Canada.

[We are] also working with research companies in Canada and they are having similar problems and it’s around safety. It’s safety working on steep slopes in the forest industry and people are being injured. #76

Conversely, (and to reinforce the similarity of markets issue) a respondent from a software provider company, case #83, that was enjoying growth of its product and associated service, particularly in Australia, UK and USA, had withdrawn from Singapore because of differences in the way that business was conducted and admitted to being naïve about the investment required to establish a market presence.

They weren’t prepared to sign purchase orders or commit to agreements and maybe we were a little bit naive with the whole way things are done in Asia. But we hired local people there, the expectation was {high}-- it ended up being about two and a half years and we got one customer up there. #83

With a service sub-sector such as software and IT services, the importance of operating in countries where English is the first language is obviously important, since there is less need for translation. This is commented on by a respondent from case #86, a company in this sub-sector.

North America being Canada and US, the attraction there was English speaking as well as opposed to going to Asia where we’re dealing with different languages and we haven’t gone down the route of translating the software itself which could be quite a big exercise. #86
In relation to our thematic framework, as shown in figure 1, service sector companies were responding to recognised opportunities in similar markets to that enjoyed in New Zealand, but the exploitation of such opportunities depended on resource capabilities. Opportunities combined with resource and dynamic capabilities could be seen as driving the internationalisation behaviour of service sector companies.

8.2 The process of internationalisation

As might be expected from our discussion in the introduction to this chapter, and in a similar way to most manufacturing companies, service sector companies entered internationalisation only after having an established domestic market base and support a network-based or staged approach model of the internationalisation process. For example, with case #77, the respondent was the owner-manager of a company that provided career training and individual personal development services had built up the company’s clients through the gradual growth of the company over eight years and was able to discuss moving into Australia. Similar to other companies he was looking to build on existing contacts and clients; this would be the first step into an overseas market.

*We’re going to go over and we’re going to sow the seed, but the conference is really of consultants, career consultants and vocational practitioners, but I’m going to use that to then tap into some various organisations that are related to the corporate clients I’ve got already.* #77

Even though some companies had IPR (in these cases, design rights and copyright) registered in a number of overseas countries, rather than enter global markets, the importance of building on relationships and careful development was important for service-based companies. For example, in case #100, the group of companies delivering a mental and disability care service were seeking to establish their presence first in the UK, but had secured IP in a number of countries that were noticeably similar in culture and potential service delivery.

*I think in the UK at the moment it’s only a fairly new company, it’s only 2½-3 years old so it’s still in its infancy and we can’t go too big too fast otherwise the whole thing will fall over. But we have brand protection right throughout Europe, Canada, brand and IP protection.* #100

These comments suggest that, in terms of our thematic framework, once in overseas markets it is contacts and networks that are important for developing the market, building upon existing contacts and trusted relationships supporting our discussion on previous evidence and theory in the introduction to this chapter. Even more so than manufacturing companies, service sector companies could be seen as taking an evolutionary approach to internationalisation. In dynamic terms, first establishing a strong and successful domestic market, before identifying opportunities in markets abroad that provided strong similarities with New Zealand. However, once markets and opportunities had been identified, networks and trusted relationships became important for consolidating a presence and building further business.

The process of internationalisation for service sector firms can be seen as a sequential one of several discrete stages involving the following: establishment of a domestic market base; identifying similar markets to NZ overseas; development of opportunities through a network of contacts and trusted relationships. This does not guarantee that firms in service sectors will remain in overseas markets. Case #73, a software service provider in the electricity market, is illustrative of these sequential stages, but in this case the company ultimately disengaged because of changing competitive conditions. They had identified an opportunity to provide their service in Singapore because of the similarity in markets.

*Singapore set up in the electricity market back in 2000, I think it was or 2001, and very much modelled on the New Zealand market.*
What we provided to this Singaporean company was energy trading and modelling software and we were very keen to grow the market there, pick up other clients, but what we discovered was that these multinationals already had people over there. #73

They were to ultimately disengage from this market after eight years, having decided that investment was no longer worthwhile, because of the change in market competition, and the company no longer has international activity.

To enter overseas markets, a joint venture or strategic arrangement where a provider works with a strategic partner in an overseas market may be more likely than for equivalent firms in the manufacturing sector. Hence contacts and networks become important in such cases. For example, a recruitment service company with a small fee income (as proportion of their turnover) from overseas markets in the UK and USA had sought a shared fee arrangement with partner in the UK.

I went over to the UK to talk to the guy in Sheffield and we had a really good chat and we agreed a share type arrangement where we work on a project with him we get a certain percentage of the fee and similarly and that was in 2007. #09

8.3 Service sector firms and outward FDI

Service sector firms are less likely to be involved in outward FDI (or ODI) that is equivalent to overseas production for manufacturing firms. In theory service sector firms can more easily service overseas markets from their administrative base in New Zealand and have less pressure to reduce costs than similar firms in the manufacturing sector as discussed in our introduction to this chapter. However, there were examples of companies that retained their development and administrative base in New Zealand, but sought to invest either in relocating staff overseas or recruitment of staff and investment overseas. In the following example from case #83, a software development and support services company in mobile worker technology, it was a case of balancing each overseas market’s needs.

Eventually we’ll end up doing all the UK customer development from the UK, but we’ll keep the New Zealand development team to do the Australian development. #83

The company had identified that recruitment of staff in the UK was necessary, as opposed to relocating staff, because such local recruited staff were more likely to understand the local market needs.

We sent a New Zealand sales person up to the UK, and he was very successful in New Zealand and Australia, but couldn’t convert any deals in the UK. Just his whole approach and manner was a little bit aggressive for that market. #83

In some cases an involvement over time with an overseas market, may lead to the setting up a subsidiary company. An example is provided from case #24 an employee-owned company in a niche area of environmental management services. In this case the company had been involved in providing services in Malaysia for 40 years and found from their experience that there were benefits from involving local people in Malaysia in the ownership of the subsidiary.

They had the ownership of that business and we found that that’s worked way, way better when they have a stake in it. #24

Having established this model, from experience this was then applied to a further overseas market in the Philippines.

We have 40% interest in a company in the Philippines called [---]. We again have a 100% subsidiary up there that we use for putting our own people
through. There’s a lot of dam supervision and dam construction type work. #24

It could be that there were insufficient numbers of companies with established track records and sufficient experience that meant this ODI model was not very prevalent, whereas it was more common for foreign-owned MNCs to operate in New Zealand.

We mentioned the highly diverse nature of the services sector in the introduction to this chapter and it was noticeable that those companies that were in IT/software development had internationalised at an early stage, giving more scope for early ODI, as such companies may seek to establish themselves rapidly in overseas markets and are more likely at an early stage to be engaged in ODI (than other service sector firms). This supports findings, for example, by Scott-Kennel (2013, p. 121) who finds evidence of early internationalisation with “knowledge intensive services”.

Some former NZ-owned companies, involved with early internationalisation, had been take-over targets and were now part of a foreign-owned MNC. This may be a factor limiting the examples of successful ODI for service sector companies in New Zealand. It could be as well that foreign-owned MNCs are more likely to identify benefits of having subsidiaries in overseas markets. For example, with case #86, a foreign owned MNC in emergency service provision, the respondent commented.

If it’s seen as a US company operating in a US market, hopefully we get more traction quicker. #86

8.4 STAFF AND PERSONAL RELATIONSHIPS

Although service sector companies tend to operate in markets that are similar in structure and culture to New Zealand, the importance of having staff familiar with local markets was still important and has already been mentioned earlier in the example of case #83. This company was also looking to develop their operations in the USA and commented on the need to employ staff there that understood the local market and can develop appropriate personal relationships with the customer.

The local people who understand the market, the locals like to talk to locals, so in America the Americans like to talk to Americans, it’s just the whole approach and the way you attend a trade show, you all wear the same shirts, you have your initials on here, you high five and all that whereas in New Zealand-- it is different. #83

The importance of the recruitment of key development staff in overseas markets to develop international activity has been mentioned as a factor for manufacturing companies in earlier chapters. Arguably, it will be more important to recruit the right staff, perhaps locally in the overseas market for service sector companies where personal relationships are more important. With case #86, the company had targeted Europe but started in the UK as being naturally the place to start.

Then the way we’d set it up there’s, we have a sales person […] who still is operated out of the UK, with the UK being the obvious base, English speaking. But we also got some early traction in Denmark, so it was kind of there, the industry itself talking about the products and us getting some leads that way. #86

8.5 EFFICIENCY AND INFORMATION GAINS

In the service sector, internationalisation brings gains to the organisation through greater efficiencies, for example, through greater utilisation of an administrative and knowledge base. This was commented on by the respondent from case #100, the group of companies involved in community care programmes, on how they gained greater knowledge from internationalisation.
That’s right and also access to what people are doing overseas, what are they doing, how are they delivering things, would that work in NZ or are we ahead of them. So our CEO’s from all the entities often attend big international innovation conferences and things. Usually once a year they will go off to a world innovation conference just to see what’s happening, what’s going on, what people are thinking. #100

Although such benefits may be intangible and focused on gains in tacit knowledge, this can be compared to the cycle of innovation that is discussed in the next chapter. A similar beneficial cycle exists, but gains may be more intangible. One objective of companies may be to gain information that allows them to benchmark the provision of their services against wider international practice. This information gain was referred to by the respondent from case #87, a New Zealand company involved in distribution systems, GPS and associated services. This allowed them to judge their service against the competition in the Australian market.

We benchmark ourselves against our competitors in Australia and there is nobody that does what we do the way that we do it #87.

And there was a need to keep pace with developments elsewhere.

So we wanted to benchmark and see if that’s the same case outside of New Zealand. If that’s something that’s a part of the nation’s psyche, or if in fact it’s just representative of a point in time, or maybe see how other countries perform. I’ve got some interesting observations in that regard as well, so it’s been a very worthwhile learning exercise. #87

This indicates the cyclical nature of involvement in international markets for service sector firms; this can be a powerful motive for engagement in international activity, the potential improvements in service provision through knowledge gained from international activity in overseas markets.

8.6 CHALLENGES

Given that the comparative advantages of service sector firms lay in the uniqueness or quality of their service provision, we might expect such companies to be less affected than manufacturing companies by the appreciation in the NZD exchange rate. In some cases, companies were effectively paid in NZDs even though their end customers were overseas such as travel and tourism based businesses, where a ‘package’ might be sold by an agent based overseas, but the company is paid in NZDs.

This is illustrated in the case of #74, a NZ-owned company in the adventure tourism sector with approximately 10% of their turnover through these channels.

I buy a tour of some description out of this brochure that I’ve picked up in the New York travel agent, and it says --whatever-- $5,000 for a 10 day tour of New Zealand---includes a [company product experience]--you know--ten nights’ accommodation and various other things and we’ll be included in that, so we sell that to the wholesaler at a net rate. #74

The importance of the appreciation of the exchange rate depended on the nature of the service provided. In other service sectors, the appreciation of the exchange rate could be more of an issue, as was the case for the provider of services associated with proprietary software and mobile solutions, case #83, but here the respondent indicated that recruitment of the right people locally was a more important issue.

The big ones for us would be I’d say: the FX is hurting us, but then also at the moment we’re trying to recruit about eight people in Christchurch and the quality of the candidates is very poor, so it’s more being able to find the right people as well. #83
In another example, case #66, for the respondent from a private training establishment (PTE) with a majority of students from overseas, it was the time involved and access to study visas and the associated processing of applications which was more important.

Everyone talks about the New Zealand dollar and the strength of the currency which is not helping, but it is still better than Australia so there are some positives in that with Australia being an imported competing destination. The strength of the currency does make it more difficult for us in India and in Japan and Korea. I think those would be the most price sensitive places. Overall, I think a major challenge for us is immigration just in terms of visa access rights. #66

The respondent pointed out that it can be difficult for students from developing nations to satisfy the study visa application requirements, as pointed out sometimes the applicants are involved in informal economies without the formal systems and paperwork that are required.

Another challenge with immigration is not the resourcing, but it’s the interpretation of documentation, particularly financial documentation and it particularly impacts on countries with less formal banking systems, so they don’t have good evidence of their financial background in terms of bank statements and terms deposits etc. The income is held in less formal means. #66

The same respondent commented that improvements had been made, but that more flexibility was required.

We feel there could be more flexibility in terms of moving forward on allowing further on-line processing rights, which I understand is part of Immigration’s agenda over the next year or two. #66

The focus on quality of service could also be a limiting factor that restricted development of potential of overseas markets due to the need to avoid risk of damage to the ‘image’ and reputation of the service. For example, the respondent from case #74, a company involved in the tourism-based adventure sector commented that there were many opportunities but also risks. These could be from potential fraud as well as damage to their reputation.

Whereas you take the same model and put it in another country and next thing someone’s stealing engine parts, selling them on the second hand market out the back door, and someone else is fudging the maintenance check sheet list to cover the guy that’s selling the parts, and buying Chinese parts. Whereas in the New Zealand culture it wouldn’t happen. #74

For companies involved in other service sectors, major challenges focused on their ability to have resources in place in an overseas market, of course this means having the right amount of staff with the right abilities. For example, this people-based issue was identified by the respondent from a software development company, case #83.

For us to deliver that we need about ten people ready to go, but we can’t really afford to go out and have ten people sitting around and doing nothing, so they’re the challenges we face. #83

Like manufacturing firms education of the market was still an important issue for developing new markets. Although the delivery of a service is resource, knowledge and people-based and dependent on relationships, there was still an education process recognised to develop new markets. The following comment was made by a respondent from case #86, an MNC-owned company involved in emergency services systems and organisation operating through subsidiaries mainly in North America and the UK, in developing new markets and new clients, the need to educate
potential new clients was commented on, recognising that it could just be the start of a process to secure new clients.

We are still going through an education process, because there’s still a lot of businesses out there, so we go to trade shows and we get huge amount of positive reaction from those and that’s where we get leads. But often they’ve got a limited budget, they’ve got a whole list of priorities that they want to deal with and we’ve got to try and get ours to come up to the number one spot, so that they actually make that decision. But in reality we’re not that high up initially. #86

As indicated in other areas of the report, those firms that were non-active were well managed companies, but limited by a focus on local markets and a desire to retain quality of service. However, a small number of firms had started to research opportunities to develop overseas markets, but were undertaking this through a carefully managed approach. For example, in case #77, in a response to a question on their level of overseas sales the respondent commented.

Absolutely nothing right now, but we have a pipeline that could see us in a couple of years easily match our New Zealand revenue and exceed it in three to four years pretty quickly. #77

8.7 Summary

Service sector companies, compared to manufacturing, rely upon the importance of personal relationships, networks and their human capital and information resource base for the quality of their service provision. They are more likely to need to establish a domestic market and have less export intensity than manufacturing companies. They are likely to be predominantly in overseas markets that are culturally similar to New Zealand, especially UK and the USA. Despite the apparent benefits of operating subsidiaries in such markets and, although we do indicate some examples of this, outward FDI, as defined for this study, seems to be relatively rare, albeit we need to be careful against generalisation. One reason may be that such companies become targets for overseas based MNCs seeking a way into the NZ market, since they benefit from having a subsidiary operating in New Zealand.

Internationally active service sector companies tend to have been less affected by the appreciation in the NZD in recent years, compared to manufacturing companies, with some not affected directly since they are paid through intermediaries in NZD. The key to understanding internationalisation behaviour of such companies lies in the importance to them of personal relationships and the improvements in their knowledge base. These are the drivers and explanatory factors behind such international activity.
9 Impact on competitiveness, productivity and innovation

The issues of New Zealand companies’ competitiveness and productivity are critical for New Zealand’s economic performance and relative GDP per capita. Theoretically companies will establish internationalisation activity in overseas markets where they have a competitive advantage, but it is also arguable that the experience of trading in overseas markets may stimulate innovation and improve competitiveness.

9.1 Sources of competitive advantage

Sources of competitive advantage could lie in the nature and uniqueness of the product, including IP, being more advanced or superior, in the value proposition and quality including sources that are information-based, or it could lie in lower cost advantages. All these sources are demonstrated in the following examples, which serve to illustrate the diversity of sources of competitive advantage.

- Superior product

I think it’s partly the nature of the product, it’s a simple product. It’s a simple mixture, it’s probably a superior mixture to some of our opposition. There’s not a lot of people that actually make this particular product either on the world scale, but our product seems to be looked on --- [as] --- one of the safest ones, because it’s made to a standard that would do the least harm #01

We’re focused on high end, high quality, so it’s got a little bit more margin in it. #03

- Lower cost

Yes cost, it’s re-engineering the product, so that you’re able to produce a product with the same, or very similar qualities, for a lower cost. It’s very hard in today’s market to get anywhere else [because] you’re vying for market share. Your consumers, it’s not like they’re going to be buying more. It is an extremely competitive market, so you’ve got to find all the edges that you can to be able to hold your margin and hold your quality. #04

- Cost and quality

A lot of what we do is design and build. So we have a lot of our own intellectual property and we really specialise in optimising that process and providing a client with a differentiated offering in the sense that we have built up a significant amount of experience in how to get that [-----] through the process plant and in to the various aggregate sizes or finished product sizes that they require for their premium products. #05

- IP and knowledge

We pitch ourselves as the top, the top quality provider of varieties, and we’re also the, probably if not the top second top priced, but we back that with our

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6 NZ had a current GDP per capita of US$32,260 in 2010, compared to a current GDP per capita for Australia of US$50.746 in 2010 (World Bank, 2012).
research programme, which is a 12 year programme, where we take all the risk. We analyse hundreds of thousands of different varieties before we get any one that might come to the market. So we’re taking all the risk up front. – And, therefore, when we bring a variety to the market, chances are it’s going to be good and the farmers know that. We’ve got a reputation that if we bring something to market it’s going to be good. #16

- Quality and knowledge

Our advantage is around the brand and the quality of the product that we market. At a product quality level we are the Ferrari of the industry as opposed to competing against the Fiats of the industry. #20

It is arguable that companies that were relying on cost advantage are likely to be those engaged with the Australian market as with our case #3 above, those in other overseas markets, or those which are labour intensive would find it more difficult to operate with a cost advantage and seek to source production overseas. The following example, from case #21, illustrates that this company could still operate with cost as a competitive advantage due to relatively low intensity of labour inputs.

One of the things for us, is the products that we manufacture don’t have a high labour component in them which keeps us competitive. One of the things we’ve always said is that a lot of people have taken product to China. One of our business units we sold nearly 8 years ago, the new owners ultimately took it up to China, because it was a lot more labour intensive, so therefore they got the benefits of the labour rates. But a lot of our products aren’t labour intensive and therefore it makes us a bit more competitive out there in the market place, because it’s just that raw material component ultimately and that raw material pricing is the same around the world. #21

Alternatively, as with case #23, there was evidence that investment in up-dated technology was necessary to maintain competitive advantage.

So what is our competitive advantage? – The investment we have made in automation probably. Automation and equipment and the technology through from order entry to delivery, we have used technology quite extensively. #23

Other companies had recognised that they could not compete in overseas markets in their main line of work, however, that there were niche areas in which they could specialise, as identified by this respondent from case #28, a NZ owned medium-sized company in the competitive printing and design sector.

The nature of our work, it becomes very difficult to, we wouldn’t be competitive for our bread and butter work overseas, producing labels or just producing graphics, it’s only for the highly specialised stuff, where we send teams over to apply it. To ensure that it’s been done to the right standard, we can compete and we have a very good reputation among the [-----] for doing [-----] graphics. #28

These examples are illustrative of the diversity and range of the sources of competitive advantage that enable NZ companies to compete in overseas markets. It is noticeable that competing solely on cost advantages is relatively rare and usually involves the maintenance of minimum quality standards as well. To maintain a competitive advantage the role of innovation, cost-based or otherwise, and investment in technology is critical. We turn now to consider the role of innovation in the next section.
9.2 The Role of Innovation

The role of innovation is regarded as a critical factor to build business growth (MBIE 2012). Indeed the corollary of this has been expressed famously by Freeman as: "not to innovate is to die" (Freeman and Soete, 1997, p. 266). We have indicated that innovation can act as a source of competitive advantage; in addition, involvement in overseas markets can stimulate further innovation creating a virtuous circle for internationally active companies. Therefore, the need for continuous innovation was an important issue in maintaining competitive advantage, as indicated by the respondent from case #13, with 33% of turnover accounted for by exports.

It's been continual development and is continually developing and as you get into the export side. #13

Innovation and developing products in response to the needs of customers in overseas markets has a role in opportunity recognition. For example, developing products for international markets can open up new opportunities. The respondent from case #14, a high intensity exporter, involved in electronic switchboard manufacture commented on the way that this had worked for his company and the way that investments (in innovation) were beginning to pay off.

In the meantime, we've developed two completely new modular metalwork systems for two specific applications in the Australian markets. Those have opened new opportunities for us as well that make us more interesting to other people, whereas the [-----] system was good for this segment of the market. Our [-----] solutions are good for this segment, so overall our exposure's increased too. We see that as being quite important. There's a lot of investment in that two or three years of slowdown developing new systems so as we're in a stronger position once things start to pick up which we're starting to see the start of now. #14

Investment in R&D is characteristic of innovative companies; involvement in overseas markets can create the stimulus for additional R&D in response to different customer requirements. The respondent’s comments from case #15, also a high intensity exporter, is illustrative of this ‘pull’ factor affecting the level of R&D.

Different sources for those and we're actually doing some interesting R&D work at present about another source which might come from a different part of the world, so that's another aspect. #15

For companies involved in internationalisation, benefits in building innovation came from involvement in an 'open system'. Open innovation systems recognise that the sources of innovation can come from external stimuli as well as internal R&D and this open system encourages higher levels of innovation than might otherwise occur. The comments from the respondent of case #16, a company with 30% of turnover accounted for by exports, in seed production, testify to encouragement of higher levels of innovation from involvement in overseas markets compared to a focus on the New Zealand market.

The only thing I’d add to it is the concept of looking outside your boundaries, it encourages innovation, so if we only work in New Zealand market we will work within the confines of the New Zealand market so that narrows down your thinking a bit. The more you expose yourself to other markets, other cultures, other ways of doing things, the more you pick up on ideas that you bring back in to the organisation. #16
The cycle of continuous innovation, referred to above, created situations in which NZ companies could be world leaders in the technology or design associated with their product and the uniqueness of the technology. The following comment from the respondent of case #48, a large sized NZ owned public limited company, which had maintained their position in the manufacture of household products and equipment, with exports accounting for 40% of turnover, is illustrative.

Absolutely, certainly in [-----], it’s really about the design for [-----], there is not a great deal of technology going into them and you can improve the quality through the cartridges and what have you, but --- we stand head and shoulders above even our international competitors with regards to innovation. No one has the [-----] technology other than us. #48

Innovation can be broadly defined, it includes improvements in organisational processes and marketing methods as well as (more narrowly) in technology and the product. Improvements and innovation in these areas can also be stimulated by involvement in overseas markets. These effects were referred to by the respondent from a company in the equine racing industry, case #54, with exports accounting for 35% of revenues, who commented on the stimulus provided to respond to the requirements of customers in the Australian market as well as making improvements in the product.

We did yes, and it was getting held up at the other end, people weren’t getting it until the next day, they were missing connections. You’ve got to be reliable or you’re out, it’s made us more reliable, what else, we’ve started earlier in the mornings, so now we get an earlier flight. We now start at half past five in the morning, whereas we used to start at seven and that enables us to get on an earlier flight, and there’s been improvements that we’ve been part of, improvements in the way the semen is processed, that gives it more longevity, makes it a bit more robust, but that’s just a technology thing, the way that’s processed. #54

NZ company innovation levels have received much attention as a critical factor behind NZ’s economic performance. This section has revealed that innovation, broadly defined, is an important source of competitive advantage that enables NZ companies to compete internationally in overseas markets. More important, the examples given in this section indicate that such involvement leads to a highly desirable situation of a cycle of innovation, illustrated by Figure 8, characteristic of an open innovation model, enabling NZ companies in niche areas to maintain a world leading position based on leading technology and design.
9.3 Networks and Relationships

The importance of networks and trusted relationships for internationalisation activities has been demonstrated by previous research (e.g., Spence and Crick, 2006). These will be important for the range of internationalisation activities that were discussed in the previous section. In some overseas countries, such networks and relationships can take time to develop and establish, to develop trust, and may require investment in time and resources. For example, we have referred to pressures on traditional manufacturers to source production overseas, yet this needs to be done through a trusted relationship. The importance of such developments is illustrated by the following comments from a respondent with case #04, a traditional clothing manufacturer, on establishing the sourcing of production in China and illustrates that benefits flow in both directions.

I think a lot of work goes into the sourcing of the factories and building up the relationships with the factories. One factory that this company’s had a relationship with for a very long time, and I think that’s why we’ve done so well, because they trust us as well. #04

(And) one thing that we have learnt is we have shared information, so they have benefited from their relationship with us, just like we’ve benefited from the relationship that we have with them. You know we’ve helped them get processes in place as well. #04

However, networks are a key factor in establishing a presence in an overseas export market and then building upon relationships. For example, the following comments from the respondent with case #13, a provider of software for gym management, with customers in Australia, USA and Middle East.

What’s been key for us is building--; we’ve made a number of partnerships with Australian companies now so we work in partnership with them and that’s really helped excel our presence within Australia and really worked for us. #13

The importance of trust behind relationships in export markets was illustrated by a respondent with case #16, a NZ subsidiary of a foreign owned MNC in the agriculture sector.
Very close relationship, yes. We don’t have signed agreements with them, we wouldn’t expect them to and they wouldn’t expect us to go anywhere else and we wouldn’t expect them to go anywhere else. -- So yes, and it’s all based on a long term relationship, trust. #16

Relationships are, of course, subject to change, key contacts can move on and it is necessary to continually reinforce networks and relationships. This was indicated by the following comment from a respondent with case #28, an NZ-owned company, with low intensity in exporting, in the print and design sector.

The best thing you can do of course is develop relationships, but people move around, you can spend a couple of years developing a relationship and suddenly it’s not there anymore. #28

We have already commented on the time needed to build networks and trusted relationships. For companies yet to enter overseas markets, building such networks requires investment in a developing a foundation from which to build an overseas presence. One way that this was achieved was by targeting overseas conferences, events and exhibitions. This strategy to gain the contacts and networks from which overseas sales could be established was effective for a number of companies. The comments of the following respondent from case #05, a high intensity exporter and technology-based engineering company are indicative of this strategy.

The [-----] industries both here, well in fact internationally, have very strong institutes, national institute bodies and, almost everywhere, they have a national conference, that’s an ideal opportunity for you to be able to go along, have a trade stand, mix and mingle with most of the senior managers from most the businesses in the [-----] industry. And that was our first targeted approach to get to know people and utilising other relationships as well. #05

9.4 Risk and Risk Management

Leaving aside risks from exchange rate movements; just operating in overseas markets brings increased risks associated with uncertainty, longer periods before payment and risks associated with new customers, whose credit rating may be unknown and risks associated with security of supply if production is sourced overseas. A number of other risks could affect companies operating in international markets such as political risk or risks with unforeseen events.

Changing economic circumstances and events can also affect credit ratings of customers in overseas markets. For example, in Europe, the post GFC environment has meant that credit ratings have altered and the risk of non-payment or default has increased in certain economies. The following respondent from case #21, a NZ-owned medium sized agri-business company commented on the way economic conditions had affected their trading patterns in European markets and the main risks that the company faced.

Risks are exchange rates and I guess debtor risk, risk of non-payment, hence we’ve had credit insurance cancelled in Europe or out of Greece, we had a customer up in Greece, credit insurance gone there because the risk profile for the credit insurers is too high, risk profile for us now becomes extraordinary high, we won’t deal with them this year. We’ve withdrawn from that market, it wasn’t a big market, but it’s just a sign of the times. Europe is struggling. We’ve utilised the NZ export credit insurance office to help improve our US market, because we had one distributor up there that was getting close to $2M US in terms of debt. The risk profile was too high,
they've helped us out, but their design (is) for the short term, establish the market and then hand that over to the normal credit agencies. #21

Some companies were able to offset the risks of changing circumstances in different markets, balancing out some of the risks. This may arise from different risks in different sector markets: e.g., retail against direct supply or it may arise from different environmental and seasonal conditions in different markets. An example of the former is given from the comments of a respondent from case #03, a NZ-owned medium sized company in a niche leisure development area, which referred to how diversification both geographically (overseas) and between sectors had ensured the continuity of the business.

The reality is that we wanted to de-risk the reliance on retail in hindsight. So we're wanting to expand the market segments we worked in, both geographically and in terms of who our audience was, and fortuitously I guess the retail environment's really struggling. If we hadn't made those changes we would be dead now. #03

Uncertainty of the environment of operating in some economies could be termed a 'political risk', in the sense that political actions could be unpredictable. This was recognised by the respondent from case #16, a NZ subsidiary of foreign-owned MNC in agri-business with 30% of turnover accounted for by exports and operating in a number of overseas economies.

The other risk is political risk, and touch wood the markets we operate in there's not too much political risk. South Africa's probably about the highest, but that looks like it's settled a bit. Chile that's pretty, that's a stable country and Australia well it's supposed to be stable. So there's not much political risk, versus Argentina, if we operated in Argentina your political risk there's high. Oh, if they just said well no more [-----] on ports. Bang that's it. #16

Changing risk profiles of different overseas markets could act as driver for companies to diversify risk (associated with different overseas economies) and develop alternative overseas markets. For example, the respondent from case #32, a small NZ-owned company in the marine sector commented on how changing economic conditions in Europe were driving them to look at the North American market, even though there were different challenges, this could be seen as a further source of innovation, as discussed in section 9.1.

Our biggest driver at the moment is we are looking at the American market because the Americans are different from the rest of the world and they have different threads and stuff. It meant that we made everything to the British standards which is what everyone in the world bar America uses and so they use NPS where everybody else uses BSP and so we have now started to broaden our range so that it covers those products so that we can focus a little more on the US market, because there are two reasons; one is we need to help grow the business and also with Europe being a bit –[----] for us, it's just a diversification thing again. You are covering yourself because the US, although it is not roaring away, it is actually in a little bit better state at the moment than Europe is. #32

A combination of risk management strategies were demonstrated to reduce the risks of internationalisation. These could take the form of ensuring that networks and relationships were carefully developed and based on trust (section 9.3), risk could be a driver of innovation ensuring the maintenance of a competitive leading edge in different overseas markets (section 9.2) and the diversification of a presence in
different overseas markets could reduce risk as recognised by the respondent from case #55, a small NZ-owned company, high intensity exporter, operating through agent distributors in 60 countries worldwide.

Well we have, to a degree we’re slightly insulated in that with so many countries, we have some areas that are pretty strong in their own right, South America is strong. Middle East is strong and those would be the two shining lights at the present moment. And Australia is not bad, but it’s eased off a little bit over the last six months. #55
Lessons learned

If NZ companies are to improve their export activity, their presence in overseas markets and gain the benefits from increased international activity that we have identified in terms of innovation, competitiveness and productivity, then it is important to understand the lessons learned from both successful and unsuccessful activities. These lessons will be important for companies considering entering overseas markets. In this section we examine lessons learned from successful strategies as well as those from the experience of companies that have disengaged from such international activity or a presence in overseas markets.

10.1 Successful Strategies

Successful strategies stemmed from having sufficient investment and understanding of the requirements of overseas markets. It may mean having to overcome setbacks and persevering in much the same way as it is necessary to do with any entrepreneurial opportunity. Similar to entrepreneurial learning, what matters is the capability to reflect on experience and put lessons into practice.

The need to understand the local market was referred to by the following respondent from case #05, a NZ-owned small technology-based engineering firm.

Oh heaps of lessons, you never get it right first time. There’s lots of lessons in terms of even our market entry. It’s very easy to look at a market, do some assessment, and then think you can kind of get in there and -- distribute. There’s no doubt in my mind that you ideally want some local presence or local understanding of the market. #05

It is important that lessons learned are absorbed and fed back into planning, again as commented on by the same respondent.

And in some cases of the larger projects, we’ve actually used an external facilitator to make sure that everybody that’s involved in that project, not just the guys that go over and do the installation, but in the factory here, in the project office, the financial people are involved and we have a lessons’ learnt output, which we feed back in to the planning for the next project. #05

The need for adequate preparation and planning was an important lesson. This is reinforced by the comments of the following respondent from case #20, a successful NZ-owned producer of agri-business equipment, a high intensity exporter in global markets.

I think some of the most important ‘learnings’ are that you’ve got to have a bit of a plan about what you are trying to achieve and where you are trying to go and because you can go set up something and, then all of sudden before you know it if you have success, it can get a little bit out of control and that’s what we saw with the European subsidiary. We had a good level of success, but we didn’t actually build robust management, financial and operational legs to the puzzle and that can have its shortcomings and then you end up mopping them up for a period until you get those strengths into that business. #20

Realising what will work in the market is also important. Customers in overseas markets may have different expectations and different customs and practices, thus entertaining different expectations about the nature of, say, trial periods and sponsorship. An example is provided of a lesson on different customs and practices learned by the respondent from case #27, a NZ owned company and high intensity exporter, specialising in equipment for the agri-business sector.
I think if you've got a wonderful device for the orchard industry, one that was environmentally friendly green device, it eliminated weed spray and we had an eccentric orchardess living in the area that wanted the device, we developed it for her, we helped patent it for her, it worked beautifully. We got the University of California interested in it, spent time with them, they said "we'd like to test it for you", which basically meant give us the machine and we'll keep it for life, that was something we learnt. I thought it was a two year loan, but I went to retrieve it they said "no, all our sponsors give us the machines". But we learnt a lot from that and it was interesting that it worked really well, they were convinced it worked really well, but there was a big difference between them being enthused and us being enthused and the market being enthused. 

As chapter 9 has illustrated, to compete successfully in overseas markets and to develop and maintain a competitive edge, NZ companies need to be at the forefront not only of innovative technology and design, but also with modern management practices. The respondent from case #32, a small manufacturing company in the marine sector was able to reflect on the need to improve management practice and the changes that the company was making.

Manufacture in New Zealand is 15 plus years behind the rest of the world as it is with the lean (management) side of things. Operational efficiency in New Zealand is [------], there is no nice way of putting it and we fall into that category because we don't have a car industry, we weren't driven by a car industry like the rest of the world was. We are way, way behind and we are looking at implementing 'lean' and I know that that is a very broad statement to make, but I understand that 'lean' is an ethos as much as a 'five S' isn't 'lean', 'six sigma' isn't 'lean'. 'Lean' is a total mind change and we are starting down that process. 

The same respondent commented on how the company had learned that a different approach was required when they tried to establish sales in the US compared to their experience with Australia.

Well the first lesson we learnt was how much time you had to put in which is something that a lot of people, and we also did consult for a New Zealand company, and that guy was trying to get into the US market and he had this idea that you just turned up and started selling stuff and it was quite a learning curve for him to understand that you actually have to put time in the market and that is something that we discovered. Because in Australia you don't. In Australia you just turn up and start selling. 

Adequate planning and preparation, understanding different market needs, building trusted relationships and the need to build experience in to future planning and activities were among the important requirements for successful strategies reported from lessons learned by respondents.

### 10.2 Disengagement

Figure 9, compiled from the Statistics New Zealand 2011 BOS data, provides survey evidence on the most frequently reported reasons for disengagement. Businesses may find that competition has increased or revenues and profits are lower than expected causing withdrawal and disengagement from overseas markets.

Experience and lessons learned in some overseas markets may lead to disengagement, perhaps from being over-stretched, insufficient resources for investment or a lack of trusted relationships and networks may lead to a decision to disengage. However, there may be more straightforward reasons such as a lack of understanding and knowledge of the market, combined with a decision to focus resources on markets with which the company is more familiar. Our findings, from
this study do not necessarily disagree with the frequency of such reasons, but are more reflective of the experience of the cohort of firms in our sample and some examples of the reasons for disengagement are discussed in more detail below.

![Figure 9: Most frequently reported reasons for disengagement from overseas markets](image)

(Source: Statistics New Zealand BOS 2011 Tables, Table 54)

The lack of networks or contacts is illustrated by the comments from a respondent with case #03, a medium sized company involved in leisure developments who had decided to withdraw from the Middle East even though, with the construction developments, there were opportunities.

*Yes. The Middle East we’ve worked in before. We’ve done about seven shops there a number of years ago and that worked quite well. I spent a little bit of time up there and what frightened me more than anything was seeing so much construction and so many empty buildings, so we kind of pulled back and decided we’d just concentrate on Australia. So, that’s kind of where we’ve left it.* #03

This illustrates the importance of entrepreneurial motivation as well as the security of trusted relationships. For example, the respondent from case #08, a small company in the competitive print sector indicated that they had withdrawn from American Samoa, due to a lost contact and reduced entrepreneurial motivation, but the right contact had led to work in Tahiti.

*Well we started going into American Samoa and then we pulled out of that, which became [--]. American dollar versus us and at that stage of course it was high, probably more like six years ago. Where else did he go?, we decided to pull out of that too, that was [--], ah he was going, we started doing a bit of quoting in Tahiti, but that also the freight costs were horrendous and then it just turned out that we met someone over there and he actually does work up there, so we do all the printing for him.* #08

Circumstances can change and lead to a decision to withdraw from an overseas market operation. For example, a change in organisation or change of ownership can lead to a re-focus of activities on core markets. This is referred to by the respondent...
from case #05, a small technology-based company that had withdrawn from an overseas market following a change of ownership.

Going back earlier in our history, we did a significant amount of export to the US, then at other times we actually had up until the sale to [-----] group, we had a distribution centre in Belgium, logistics and distribution centre in Belgium and we had a UK subsidiary company that we operated for one of our product ranges. That was from 2002 to 2007. What happened was the [-----] group bought [-----] but didn't want to buy that particular product line so we sold that product line separately to another company and they now operate it. #05

We have indicated in the previous section, the importance of planning and preparation. However, markets may not materialise in the way that has been planned and this in itself can be a reason for disengagement. As the entrepreneur gains information and adds to their knowledge, this leads to a change in decision-making. An example is provided from a respondent with a NZ subsidiary company, case #15, that is engaged in the tanning sector, who reflected on experience gained and disengagement from three overseas markets.

(At) one stage we had a real push into Spain, but that didn't ever really work, but it looked from a distance at least we should give it a crack. We had an earlier run into China at one stage, but going back about 11 or 12 years ago now and we actually had an office over there, but we were just a bit ahead of the game there I think, which didn't work for us anyway so we pulled out again there. And we had quite a good association going for a period with a Russian retailer, but the two things there; one, they fell on hard times which didn't help and quite frankly the corruption made it just too difficult to work in to that market. #15

The importance of entrepreneurial motivation and perseverance is important for overcoming challenges. It is worth noting the comments of the following respondent from case #37, a NZ-owned company involved in the food processing sector on the perseverance required to enter the Russian market, which might easily discourage others.

I was a good launch for us at the time, we're very proud of it; it took a long time to get there. There's a lot of bureaucracy and loopholes that we had to jump through to be able to export into that market but once we got there it was great achievement for us. #37

A further factor is the nature of opportunistic activity. Entrepreneurs may identify opportunities in overseas markets that are essentially temporary, provided from existing contacts, and will not lead to a long term presence. For example, the comments of a respondent from case #23, a NZ-owned company in agri-business sector illustrate this approach, which did not generate sufficient interest for a longer term investment and presence.

Well our activities in South East Asia have been quite opportunistic where they have generally been referrals from existing contracts and somebody has said; "hey we use these guys over in [--NZ--], why don't you try them out to do such and such", so they come to us and we do something and they say "oh we know somebody" and we do something and so it carries on. That is just not happening at the moment, so the barrier for us is to build up a viable long term business is actually quite high, so we consider to perceive that South East Asia as an opportunistic activity, so we will be ready to respond when people want to and we keep in touch with a few people just to remind them that we still exist, but other than that, we don't actively go and market there. #23
Other circumstances may mean that the product and operation are no longer economic and viable. For example, with the following NZ-owned company, engaged in a niche manufacturing sector, making shelving products, the respondent commented on the changing competitive conditions.

We’re in Singapore for five or six years but then our product became uneconomic relative to local competition. #45

In the chapter on service sector businesses, we mentioned the importance of having a strategic local partner to establishing a successful presence. For example, case #73, in the management of services, mentioned that the company had initially identified Singapore as a target overseas market, but disengaged after eight years. In reflecting on that experience the respondent commented that in the future they would look for a strategic partner.

So, for example, if we went to just using Australia, we would look for a company in Australia that had similar capabilities to us in terms of their being able to understand how the electricity market works, but relates to the software. #73

Lessons learned may arise on the supply side as well as the demand side, that is from sourced production overseas, such as the examples given in chapter 6 on international activities and behaviour, this may lead to subsequent disengagement. In that chapter we mentioned case #15, a traditional textile manufacturer, high intensity exporter and subsidiary of a foreign-owned MNC, indicating that several attempts had been made to source production in different countries, but without a stable and trusted relationship it could take several attempts to be successful. This was commented on by the respondent, referring to the parent company.

They have a long history of chasing cheap wages. They were manufacturing in Japan, their first foray overseas was in Korea and they got their fingers well and truly burnt because they got in there cheap and suddenly the Korean wages just shot up. I’m going back oh, late 80s early 90s now. But they didn’t seem to learn their lesson. They then moved to Thailand and wages went up and they moved to Vietnam and the wages went up, they went to Laos and that didn’t work. So they’re now back in Thailand, so they’ve been bouncing around like that. #15

10.3 IMPORTANT FACTORS

This chapter has examined the lessons behind successful establishment and disengagement in overseas markets. It has illustrated the importance of a number of factors including: entrepreneurial motivation, changing economic circumstances, adequate preparation and planning and the importance of having trusted relationships with contacts and adequate networks in overseas markets.

Having discussed some of the lessons learned from successful strategies and from the experience of those companies that have disengaged, we conclude this chapter with an indication of the importance of factors across our sample companies. To some extent, like any market opportunity, international activity of any type requires careful planning and preparation. These factors reflect the need for adequate preparation and investment in time. The following are suggested as being important factors that arise from lessons learned.

a) Investment in resources and presence in a target market. Although some companies used agents successfully, these need to be chosen with care.

b) Precursor assessment of the market, including gathering of information from contacts and industry sources.
c) A long term commitment to that market, including time required to establish a market presence.
d) For service sector firms, having a strong and established domestic market and identifying similar markets.
e) Capability to learn from experience.
f) Feedback systems that enable review of operations.
g) Building strategic partnerships that can enable joint ventures.
h) Establishing robust reporting systems from the beginning including forecasting.
11 Sources of information and advice

11.1 Own business and industry contacts

Businesses in our sample relied predominantly on their own business and industry networks to source information and advice in relation to internationalisation. They seemed to be mostly self-reliant with a range of proximal sources of learning available to them. It seemed that availability of, and access to, information and advice were not perceived to be a problem. The majority of respondents felt that there was enough information available and they described themselves as capable of accessing information and advice using a variety of channels.

Case #4 is a long established clothing manufacturer selling to major retail chains and other retail outlet stores. The major markets were the NZ domestic market and, of smaller importance, the Australian market, but their other internationalisation activities concerned outsourcing production overseas through existing contracts and relationships with two Chinese clothing manufacturing factories. The outsourcing of production had been driven by the need to reduce costs in a competitive clothing and fashion sector. To outsource production overseas they had sought advice from their network of business contacts, who had similar experience and had undertaken a similar switch of production facility. Trusted sources of advices included:

- Business peers:
  
  *Our managing director talks to other businesses that manufacture offshore to get advice. #04*
  
  *The chairman of our board is chairman on several other boards who also have offsite manufacture. #04*

- Professional advisors:
  
  *For market advice we use consultants. #04*

- Suppliers:
  
  *We talk to the partners that we already have over in China and get their knowledge as well. #04*

Other sources of information and advice that were mentioned by respondents included industry bodies, clients, distributors, parent and sister companies, as mentioned by the respondent from case #16 in agricultural seed production.

- Industry bodies

  *[Name of industry body] is the organisation in New Zealand that looks after [xxx] certification. There’s an annual conference, in fact there’s one happening right now in Helsinki. I’ve been involved in some of those, so we’re tied in to our industry bodies. #16*

Other examples of trusted sources mentioned by respondents included clients, distributors and parent and sister companies.
11.2 The role of Government Agencies and Programmes

In relation to public sector sources, New Zealand Trade and Enterprise (NZTE) was by far the most frequently mentioned source of information and advice. However, the role NZTE played in the internationalisation process differed depending on the type of business.

Small businesses that were considering exporting, at an early stage in the internationalisation process or were experienced but small scale exporters were generally aware of the services NZTE offered, but most of them had not used them. They perceived themselves to be too small to fit NZTE’s service focus.

Case #13 is a young software developing company in gym management, employing 12 staff. It is a family business, run by father and son. It exports its software around the globe, but individual contracts tend to be small. They are only actively developing the Australian market which is perceived to be the most similar to New Zealand in relation to language and culture, but with more opportunity for growth. For the future, they are looking at potentially expanding into the US and Canada. Ideally they would like to establish offices overseas, but financial restrictions do not allow so. Although respondents have identified growth opportunities, the biggest barrier to growth is finance, as the business is operated on cash flow only. Respondent felt “embarrassed about asking for assistance” because of the small scale at which they are currently operating.

I think it’s just a matter of scale that you feel embarrassed about going to ask for assistance when we can’t afford to have additional staff to do things, to be tapping into somebody else’s support, but it’s certainly something that we are open to. We are aware of the fact that there is assistance out there and as we grow a bit and decide to tackle the Canadian or the US market in the next year, it would be helpful for us to look at what assistance there is from NZTE. Just to make life easier, so that we don’t make mistakes that somebody else could have said “don’t do that”. #13

In contrast, case #47 was a traditional manufacturing company making gutters, pipes and fittings for the building and rural market. The main international activities are concerned with the import of the company’s raw materials and exports to some of the Pacific Islands. Exports account for 3-4% of the company’s turnover. Some of their overseas markets have been in decline, notably Fiji, where there is a local manufacturer. The main sources of information were regarded as being the Internet to gather information about what their competitors are doing as well as for markets, replacing to some extent the importance of trade fairs. The company made no use of public sector sources or they were of little relevance. In response to a question on whether they had used NZTE or government agencies the response was:

No never, no not at all. Selling to some of the Islands doesn’t justify it. #47

The second group of businesses tended to be growing businesses some of which had established overseas markets and were now actively expanding into new markets or taking steps in the internationalisation process such as overseas production. Services that these businesses tended to access included the following:

- Seminars
- Market information and research
- Access to markets via networks
- Lean manufacturing
- Better by design
- TechNZ
- Export mentoring program
- Summer student grants
- Financial assistance to reconnect with overseas customers after the Canterbury earthquakes

Case #32 is a niche producer of injected moulding plastics products for the marine sector. They have had a carefully managed and staged approach to internationalisation, but have developed to have 27 distributors in 22 countries and have seen recent growth in exports. They still see considerable potential in the marine sector and their target is to become an OEM supplier to major boat builders who could be in Europe and Middle East. Their main challenges were considered to be visibility, and having a base in overseas markets, as well as restructuring the company to meet international operations. They are currently implementing lean manufacturing system to improve efficiency and are actively working with NZTE and the respondent considers the support they receive to be useful and “significant”.

For us it has been significant. It has been the difference between us doing it and not doing it. #32

The third group of businesses were mostly foreign-owned and/or large in scale. Some were New Zealand owned, but representing a large multi-national brand in New Zealand. These businesses might or might not have used NZTE’s services before, but seem to have outgrown the level of support that NZTE provides or, in the case of foreign owned firms, were no longer eligible for support.

Case #14 is a switchboard manufacturer. They established an Australian operation a few years ago. Australia is the most attractive market because it has similar electrical standards as in New Zealand, but was considered to be years behind in relation to switchboard technology. The office was originally set up in response to regulation that out of state companies, i.e. NZ companies, add 10% to their offers which make them less competitive compared to their Australian competitors. They are importing and redistributing electrical products and represent a major European company in New Zealand. This partnership with the supplier has proven beneficial in terms of learning and support networks and they are now looking into licensing part of their production to China, Laos or Vietnam with the support of their supplier.

They [supplier] have got offices all over the world, so we would ring their sales’ guys in the particular country and they'll send us all the information we need to know and so that provides us our best route for information and probably the one we use the most. #14

Another example was case #19 that is part of a global group that produces computer networking equipment. The New Zealand operation which employs 120 staff is the largest R&D facility of the group which has its headquarters in Japan. The NZ business was purchased by the company in 1999. It has since invested in a purpose built office and staff and helped the company grow which wouldn’t have otherwise been possible. Having access to a worldwide sales structure through the holding is of particular benefit. The business had NZTE assistance in the past, but believes that the funding schemes have become irrelevant for foreign owned businesses in New Zealand.

All of the NZTE funding that came through last year which all looked very promising; none of it was relevant for people who were foreign owned. #19

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7 It should be noted that the 10% penalty is historical and no longer applies under the Australia New Zealand Procurement Agreement (NZGPA), see also a comment on NZGPA on page 29.
8 However, it should be noted that NZTE’s policy is to support a foreign-owned firm so long as it considers that there is domestic and/or export value to New Zealand in doing so.
12 New Zealand environment

Respondents were asked how the New Zealand environment affects their ability to compete internationally. Care has been taken that comments by respondents were related to the international activity of their business. A number of factors were identified that related to the regulatory and physical environment, innovative technology, labour and New Zealand’s reputation for quality. The individual experiences in relation to those factors, however, varied considerably.

12.1 REGULATORY ENVIRONMENT

The regulatory environment was generally considered robust with a healthy banking sector, no corruption and a regulatory framework that made it relatively easy to do business in New Zealand. New Zealand’s regulatory environment was particularly positively rated by respondents with experience in a range of different overseas markets and different types of international activities such as overseas production.

Case #5 for example, is a specialised engineering firm that designs and builds equipment for mining and quarrying applications. Their pattern of activity has changed historically and included a UK operation that was sold off, so that they could concentrate on core markets, especially Australia. A Belgian logistics centre was also mentioned as one from which they had withdrawn. The recent mining ‘boom’ in Australia has enabled them to exploit unmet market niches and market gaps. Other overseas markets included India and Qatar.

*I find the business environment in New Zealand extremely positive. I think it’s great, in all of the surveys we are very high up in terms of that ethics and ease of business. […] And our banking system in New Zealand is excellent.* #05

Case #14 is a switchboard manufacturer. The company has become the only United Nations accredited switchboard manufacturer in Australasia and is now undertaking their installations across a wide range of countries. The respondent believed that New Zealand’s sound regulatory system has helped them achieve accreditation.

*We are recognised as being a clean country to deal with and so with the UN, they don’t have issues about bribery, and all that type of stuff, dealing with New Zealand companies.* #14

Another example is case #55, a small company that makes a special niche filing system for large sheets of paper such as building plans, architect drawings, etc. They are exporting to 60 countries and the respondent believes that New Zealand’s reputation for good quality as well as ‘respectable and honest business dealings’ helps with clients from Arabian as well Asian countries.

*We’re generally known for very good quality and for respectable and honest business dealings. It does carry a lot of weight. In Arabia for instance it carries a heck of a lot of weight. And of course in Asia it does as well.* #55

12.2 PHYSICAL ENVIRONMENT

New Zealand’s clean and green image was mentioned frequently as being important particularly for the wider food manufacturing and agricultural sectors. Case #21 is an agricultural manufacturer that operates across a wide range of areas such as applied dairy technology and feed conservation amongst others. New Zealand’s reputation assists them in the international marketplace.

*What helps us is New Zealand’s reputation. New Zealand has a very strong reputation for innovation, agriculture and of course clean and green.* That is
of reasonable assistance in the international market place because when you are talking to the rural communities over there, they know where New Zealand sits in terms of agriculture, they know that we know what we are talking about and that gives you a foot in anyway. #21

According to other respondents, however, it depends on the overseas market how well received New Zealand’s image is. Case #37 is a food manufacturer who is part of large multi-national. According to the respondent, the importance of New Zealand’s image as being clean and green is ‘massive’ for the business. It does, however, depend on the overseas market. While the New Zealand image carries a lot of weight in some markets it is outweighed by the strong ‘buy local’ movement in other markets.

It really depends on the country. Middle East is very open to New Zealand and they love the imagery of New Zealand and that’s a big part of our business there. The US market is very patriotic and, as soon as highlight that it’s not from the US, then they get a little bit ‘anti’. Same as Europe, there’s a big drive on to buy local. #37

Respondents from businesses outside the food manufacturing and agricultural sector, however, believed that the reputation of their brand was ultimately more important than New Zealand’s reputation.

Outside of those primary markets, for us the leisure marine products, which we actually manufacture in Australia and export, that’s not so important, it’s the reputation of the brand that the company has built up, not the country that it’s coming from. #32

Another factor that is closely related to the clean, green image is New Zealand’s environmental safety. While the first factor is arguably more a perceived factor, the second one is more concerned with actual standards and procedures. For case #44, a food manufacturer, New Zealand’s biosecurity is of crucial importance.

New Zealand is pretty well protected from animal disease, which is one of the problems that can stop the business altogether. So that’s an advantage. In fact the first export market was due to anthrax outbreak in Australia, which meant that our competitor couldn’t export to Saudi Arabia. So we started exporting to Saudi Arabia […]. I’ve found, particularly in the Middle East, and also in Asia, New Zealand is highly regarded as a safe source of food products. #44

Biosecurity, however, does come at a cost for some businesses, particularly for low value manufacturers that operated on low margins. In these cases, the cost of complying with biosecurity regulations outweighed any advantage. But, it depends where your market is and what costs your competitors are facing. Case #54 is a stud farm specialising in breeding from stallions for harness racing. They are exporting semen to Australia where they are competing with businesses which face much lower biosecurity compliance costs. At the time of the interview the respondent commented:

It’s my bugbear that MAF’s mission statement is that they’re there to promote New Zealand’s products and export as part of their mission statement. We can’t put our costs up, because we’ve got to compete with the Australian market, but like some of our costs with MAF have gone up several thousand per cent. They used to just charge per dose of semen - just a token amount that gave us an obligation to report to them for a statistical point of view, but now they’ve turned that around into a profit making venture. What was costing us a matter of cents per dose, they’re now charging us several dollars per dose and it all just adds up. MAF always kind of work backwards, they feel they should make a profit and on charge the cost to us, but for an exporter it
makes it very hard, because we can't pass those costs on, because we've got to compete with the local market and no one in Australia cares that MAF's charges have gone up. If the costs become too big, then you just don't do it. That's my fear at the moment. That the MAF charges are just getting dearer and dearer and we can't pass those costs on. #54

It should be noted that MAF (now the Ministry for Primary Industries), is statute bound to cost recover for service provision on a user-pays basis. This was implemented following a review in 2010 to stop cross-subsidisation of services.

The advantages and disadvantages of environmental regulation were another point of discussion for respondents. Environmental regulation was considered to be relatively relaxed in New Zealand, particularly compared to some European countries. While the low compliance costs in relation to effluent disposal were a competitive advantage for a sheep skin tannery, the limited recycling opportunities were a disadvantage for a print solution provider.

Case #15 was a small sheepskin tannery, a subsidiary of a foreign owned MNC. Having a tannery in New Zealand provides them with a competitive advantage because of plentiful and relatively cheap fresh water and well working council effluent disposal systems. Disposal in other countries is apparently much more expensive for businesses than it is in New Zealand.

Effluent disposal is the biggest environmental thing that you've got to comply with and that is pretty similar in most places that we're dealing with. We actually have a competitive advantage here in that we've got a very good municipal treatment plant and they're saying put it down the drain and we'll sort it. Not quite that simple, but essentially though we're only doing a pretty minimal level of treatment on site and we pay them to treat it and that’s something that becomes quite a bit more expensive in other parts of the world, so that's an advantage. #15

For case #28, a print solution provider, New Zealand’s lack of recycling infrastructure is a disadvantage. The business deals predominantly with large overseas corporates whose environmental policies are based on European standards. This does not only affect them in the international market, but in the domestic market as well.

New Zealand being such a small country, it's not feasible to recycle anything. So it is a problem for us and we're looking at ways, but every way costs lots of money, it means more capital expenditure. Not only international markets, but our own domestic market, where it's being driven by an international company. If you took [name of client] for instance, they have a head office in Europe and are driving certain environmental standards - mainly around recycling - but based on what you can do in Europe. But everything they do applies worldwide, so they will eventually impose it on us, but we've got no avenue to do that in New Zealand. I can see what's happening, we'll lose the work and it will come in from Europe or the States or somewhere, which will be counter-productive. #28

12.3 Perceptions of New Zealand’s Innovative Capacity

Some businesses, particularly in manufacturing and services and less so in the agricultural sector, felt that New Zealand is perceived as a laggard when it comes to innovation. Respondents argued that internationally New Zealand’s smallness and remoteness was often associated with a lack of innovative capacity.

Case #26 is a designer, manufacturer and distributor of customised and standard food display and storage units for use principally in the food service and retail industry. They have operations in New Zealand, Australia, China, UK and USA.
China is a production base for its standardised product sold mainly through independent dealers. New Zealand, however, remains its worldwide product development centre for and manufacturing base for customised products. The business seeks to build its overseas presence by stressing the company’s global capacity and links to international business clients. The respondent believes that the association with a small New Zealand town does not help when trying to enter large markets and for that reason New Zealand is never mentioned as the head office, although in fact, it is.

The home country is here. New Zealand is the head office, but we specifically don’t have it mentioned as the head office. New Zealand is probably the smallest country that we actually operate in, so it’s better for us to have the persona of not necessarily being associated with small town New Zealand. The reality is though that this is the design hub, custom manufacturing centre, global corporate support centre as well for all the other countries. #26

Case #13, a young software development company is facing the same problem.

They just have this perception that we might be backward or behind the times and this is just comments that I get when we are overseas. #13

In contrast, case #32, a niche producer of injected moulding plastics products for the marine sector argues that their competitive advantage lies in the quality and innovation that New Zealand represents. This illustrates again that experiences of respondents seem to be individually different depending on the nature of their product and nature of the market that they serve.

We are in New Zealand because - I know that sounds really funny - but when you buy a boat that is worth a million dollars and you pull the manifesto out and it is has got all the bits that it is was made from, do you want to see made in New Zealand or made in China? I can tell you now the Middle East said to us if we got all our dyes sent to China the manufacturer wouldn’t buy any of us. New Zealand is seen as a quality and innovative brand and so we have been able to piggy back a little bit off that. #32

12.4 LABOUR COSTS

A key factor of the New Zealand business environment was the availability and cost of labour. The availability of labour was already discussed in a previous chapter, so this section only focuses on the labour cost. It has been deliberately separated from the issue of labour availability as this was predominantly considered a challenge. Labour cost, however, is not necessarily a constraint for all businesses. Whether the cost of labour is considered a constraint or not, depends on whom the business is competing with and how high the labour costs of competitors in overseas markets is.

Case #17 is a small engineering company that has recently started doing work in Australia. For their operation they need to ship heavy machinery, which makes exporting unprofitable because of the cost of transportation. Australia, however, is an exception. Lower labour costs compared with Australia allows them to successfully compete there despite the transportation cost.

Labour rates are lower and that’s why we’re cheaper compared to Australia. #17

With case #19, a Japanese owned producer of computer networking equipment, comparably low labour cost, combined with a knowledge and skills, has secured the New Zealand operation.

So but there’s, there’s no particular reason for hardware and software to be done in the same place and we had a strong software development team
here so they've concentrated more of the software development here. [----] And it has the advantages of being relatively cheap. #19

Case #51 is an exporter of frozen vegetables with sales in Australia accounting for 60% of current turnover. High labour costs in New Zealand are the main constraint on expanding exports with competitor suppliers in South America having substantially lower costs.

The whole New Zealand cost structure, compared to our opposition, which is South America, Eastern Europe or China. But we can't compete even with countries like South America. Where are the major costs for our business? Labour. #51

As a result, concern was expressed by the respondent from case #20, a producer of equipment in the agri-business sector, in the light of rising labour costs and the government's aim to get pay parity with Australia.

The Government is talking about wanting to get pay parity with Australia. If we think through the logic what pay parity with Australia means – it means we are going to increase the cost of labour, so that increases the cost of manufacture, so it increases your sales price potentially or cuts your margin, one of those two, so, therefore, you either sell less or make less. So why manufacture? #20

While this manufacturer was seriously concerned about the impact rising labour costs have on the competitiveness of the business, another manufacturer believes that they can still remain competitive despite rising labour costs. Their products have got a far lower labour component because production is to a large extent automated.

A lot of our products aren't labour intensive and therefore it makes us more competitive out there in the market place because it's ultimately just the raw material component that raw material pricing is the same for everyone around the world. We have a lower component because we have got a lot of automation. #21
13 Observations on policy

Respondents were asked if and how specific policies affected their ability to compete in international markets. These policies were migration policy, the Overseas Investment Act and free-trade agreements.

Particularly the migration policy and Overseas Investment Act didn’t reveal much, as observations were mostly general rather than related to the international activity of the business. More substantial comments, however, were made in relation to free-trade agreements.

13.1 The Role of Free Trade Agreements

Respondents were asked if New Zealand’s current bilateral and regional trade agreements have influenced their international activities and future plans. If and how free trade agreements impact on a business depends on the nature of the product and the firms’ competitive advantage. The impact FTAs have on businesses are quite complex and sometimes ambiguous with positive and negative effects at the same time.

High-value manufacturers for example were mostly unaffected by duties and tariffs and were therefore not facing any market entry issues per se. Instead they were facing other barriers such as finance, exchange rates or visibility in the market. Although they weren’t currently affected, they were constantly monitoring the development of FTAs and considered them to be important for New Zealand in general.

Case #27 is a small engineering company making specialised mowing equipment for markets that require a high quality finish. The major export markets are European, especially the UK. Export accounts for as much as 80% or more of turnover and are considered to be critical. A decision was made 2-3 years ago to invest in a production facility in the UK to serve UK and European markets. Apart from the importance of the appreciating exchange rate, in addition the lead time to meet orders has been an issue for the company; it can take 6 months from order to delivery allowing for shipping times, a long period to finance credit.

The code that applies to our machines so far has been duty free, so no barriers there. We face different barriers. #27

Some low-value manufacturers in our sample, however, were facing high tariffs in some countries and are welcoming progress on free trade agreements. Cases #37 and #44 are both food manufacturers. For case #37, Australia is by far the major overseas market, followed by the USA, Japan and Korea. Australian exports are well established and with a similar market and food tastes it is a comparatively accessible market, helped by CER. Considerable potential for growth is seen to exist in Japan and Korea. In these markets, their products are well received and as they supply a staple demand there is believed to be much scope to expand sales. The main constraint, however, is the high tariff on imported food.

We’re confident that a free trade agreement with Japan could easily double or triple our business there. #37

Whether tariffs are a barrier or not depends on how price sensitive the product is and this can be different depending on the market. For case #37, their products are very price sensitive in Korea, but are less so in the Middle East where they get a premium price. The tariffs faced when exporting to the Middle East are therefore considered less of a barrier compared to Korea.
We’ve got a very super premium position in the Middle East whereas the products that we’re playing in Japan and Korea certainly are much more sensitive to price. #37

Case #44 is also a food manufacturer which has so far concentrated exports to East Asia and the Middle East. Russia and central Asia had been identified as a potentially new and important region for the company, but at present tariffs on imported meat products are too high a barrier. As a result the respondent is watching the progress of the negotiation of a free trade agreement with Russia and its Customs Union partners Belarus and Kazakhstan with great interest. The respondent noted however, that a FTA with Russia would only be an opportunity if New Zealand then has an import duty advantage over other countries, particularly Australia where major competitors are located.

We will eventually have an import duty advantage over other countries, although I imagine that Australia will follow fairly quickly on New Zealand heels to get free trade agreement with Russia. #44

The question of whether free trade agreements provide a level playing field was mentioned by another low-value manufacturer. Case #60 is a small hosiery manufacturer whose main export market is Canada. The business has been negatively affected by New Zealand’s FTA with China with Chinese competitors selling socks to New Zealand. The respondent argued that as long as there are no equal regulations across the two economies, trading under the free-trade agreement is not fair.

I have no problem with a free trade agreement - say myself selling socks into China and China selling socks to me. I have no issue with that as long as it is competitive, but it isn’t. Our minimum wage and the conditions, constraints and compliance of what NZ businesses are facing as opposed to a business in China. I have no problem with a free trade agreement if it’s a fair trade but it’s not. #60

However, the increasing pressure in the domestic market from Chinese competitors has led the business to investigate new market opportunities – in China.

Because the middle class in China are getting wealthier they have got more disposal income, so what is actually happening is they don’t necessarily want to buy Chinese made products. They love the possum merino product so they are looking at a higher, more elitist product – say from NZ. #60

13.2 Other observations on policy

Apart from the comments on FTAs, and as mentioned in the introduction to this chapter, there were a small number of additional comments that were concerned with policy; on visas and immigration policy and where relevant on the Overseas Investment Act. For completeness we report on these factors here as other observations on policy.

Visas and immigration policy

For the most part, obtaining visas for skilled labour migrants was not seen as an issue. For example, with case #13, an IT company involved in both hardware and software systems, the respondent indicated that recruitment and obtaining visas was not problematic.

It is very helpful to be able to have a choice of overseas people and that there is no huge immigration issue. If they have got their degree, and done nothing wrong, it seems that they can get a work permit pretty quickly and that’s good. If we had to sit around waiting for three months for someone to get a permit to
be able to start once again that would be a huge disincentive, but at the moment the wheels seem to turn over fairly quickly. #13

Whilst case #13 could be considered a typical response, with case #03, a company involved in the manufacture and fitting of high quality joinery products, obtaining visas for skilled migrants was seen as more problematic.

I’ve written lots of letters in the last 10 years mainly in terms of pushing our business as an area that we have a shortage of skills, so we shouldn’t have to go through so many hoops in order to get the people that come here on board, you know, Germans and Ukrainians and Russians - we have to go through quite a few hoops to prove that they are in areas that we’ve advertised and we couldn’t find. #03

In chapter 8, on service sector businesses, we mentioned case #66, a private training establishment, where the respondent had commented on the difficulties in the process of obtaining study visas for overseas students. The respondent commented on the slowness of processing such overseas study visas and suggested that more resources could be allocated to help speed the process.

We feel that there’s insufficient resources being put into supporting the industry overall in the main markets, particularly India we see delays in visas being approved and students regularly missing the start of the trimester and having to wait for three months to the next intake. #66

**Overseas Investment Act**

The Overseas Investment Act (OIA) affected relatively few companies, but those that it did affect indicated that it is a process that they had to go through and it was not regarded as a major issue. This is illustrated with case #47, an NZ subsidiary company involved in supplying pipes and fittings in construction and related markets. The respondent commented that it is considered merely as a process that has to be undertaken, but is not seen as a significant issue.

We go through the process but we have never seen it as a hurdle. It is something that has to be done, but it is not something where we would say “No, we won’t go there because it is difficult”. I would say our parent company would view NZ as a very good and easy place to do business regulation wise so even with the changes in capitalisation rules of recent times [it has meant] we have had to restructure our borrowings, but it is not enough to make them think ‘oh NZ is hard’. #47
Respondents were also asked about their internationalisation plans for the next three years.

Given that the predominant strategy that was used by respondents was a staged or network approach, with entrepreneurial decisions often following a systematic and sequential process commencing with a culturally similar country e.g. New Zealand firms going to Australia, the envisaged future activity depended very much on which stage the business was currently at. Subsequently, decisions are taken to serve international markets that are seen as more culturally dissimilar and possessing more risk. For example, it has been suggested that this process develops on the basis of entrepreneurs gaining information and perceiving risk differently based on experiential learning. Entrepreneurs typically analyse the costs and risks of internationalization while taking into account their own resources, especially regarding their knowledge when entering new markets. International market selection is an important component of the firm’s internationalisation efforts. Not all markets have the same potential and so entrepreneurs and managers need to consider where to expend their efforts and limited resources.

A range of factors have emerged that impact on international market selection. These include:

- Similarity in relation to language, culture or regulatory systems

With case #14, a switchboard manufacturer, Australia will remain the key focus for future development because of similar electrical standards.

*Its electrical standards are the same, the way they do things is very similar - not exactly the same, but very similar. *#14

The importance of similarity was even found for bio-tech firms, such as case #01, a producer of pharmaceutical products who is in the early stages of the internationalisation process and sees Australia as their biggest future market.

*Australia is going to be a huge step for us. It’s a very similar market, they think the same, they’ve got the same sorts of public private structures, the government departments are relatively similar, the laws are relatively similar, and everything’s pretty much the same. *#01

With case #51, a small exporter of frozen vegetables, a market opportunity has been identified in Japan, but the respondent is hesitant to actively enter into this market because of language difficulties. He would, however, consider it, if approached by a Japanese distributor.

*We haven't got the language capability to deal with Japan, but I believe that we would have the ability to deal with the US. But a trader might come to us and buy from us for Japan.* #51

- Networks and relationships

Existence of linkages seems to be a key factor for international market selection. These linkages might be strong or weak, proximal or distant, private or business related, recent or historical.

In the case of a small sheepskin tannery, case #15, China is seen as an upcoming market. The respondent believes that it is important to have linkages into the overseas country that you are targeting; because they help you better understand the market. In his case the linkage to China was through an Australian raw skin sales person who worked for a Chinese operation.
A lot of it comes down to those sorts of linkages as opposed to going out there and researching a country and saying 'we have a go'. #15

- Market access

In the case of a large food manufacturer, case #37, market focus will shift from Europe to China. In the European market, the company was traditionally facing a high tariff which in combination with a deteriorating exchange rate has made it an unprofitable market. The free-trade agreement with China, however, has removed the previously existing tariffs and now makes it an attractive market. Similarly, Korea and Japan would be of great interest to the business because of potential for growth, but the currently high tariffs have ruled those two markets out for expansion.

China really has become a market we look to develop further and I’m actually going to them next month for a couple of weeks. Meeting with all the senior people in Shanghai to discuss opportunities and present products to them. #37

- Physical closeness

Due to the nature of their product, some businesses rely on markets that are physically close. Examples are heavy machinery that incurs high shipping costs or fresh produce.

It’s got to be a primary target for us just purely from a logistics point of view. I mean shipping stuff can be expensive. #05

- Knowledge of and familiarity with the market

Physical closeness often comes with increased market knowledge and familiarity with the market. In the case of a long established clothing manufacturer, Australia will remain a key focus because of the market intelligence they have built up over the years. While there might be other attractive, but more distant markets, they are associated with more risk because less is known about them.

It’s the closest market yes and it’s a market that our guys know. It’s not a total unknown and it’s not so far away that you don’t know what’s going on. #04

- Infrastructure

Depending on the nature of the product and how the business services its market, infrastructure might be an important point for consideration for future market development. In the case of an agricultural manufacturer, transportation infrastructure is considered important to be successful in the overseas market.

If they didn’t have a good transportation system in Chile, then there wouldn’t be a good market for us in Chile, so we wouldn’t be there. #16

- Market size in relation to internal capacity

If the size of a market is large or not ultimately depends on the nature of the business. While a large market size might indicate a large opportunity, some businesses approached large markets very carefully so as not to stretch their own internal capacity. Again, in the case of the pharmaceutical producer that is at an early stage in the internationalisation process, Europe and the US have been ruled out despite them being large and attractive markets for the business.

We haven’t explored Europe or the States or anything like that. It would be a huge step forward and I guess that might be in the next ten or twenty year plan, but I think we would really want to get ourselves firmly established in New Zealand and Australia first. I think with the size of the company that we have, and the type of specialised products we make, I don’t think we would be able to get into those markets, that would be a huge quantum leap on our capacity and scale. #01
Overall, the choice of future market focus depends on a range of factors that often exist in combination. Internal capacity and capability factors are equally important as factors related to the target market.
Conclusions and implications

The 98 interviews conducted for this study covered a variety of businesses and a range of international activities, including a sample of businesses who were not actively engaged in any international activity. The following conclusions focus primarily on the results from independent New Zealand-owned businesses that were engaged in international activity, however, we also comment on the results from non-active businesses and some of the implications for support and policy.

- For many businesses, the limited nature of the size of the domestic market in New Zealand has been the main spur for export activity and engagement in international markets, permitting business growth, economies of scale through larger operations and, in some cases, has even been necessary for survival. The indications are that this factor was particular important for NZ-owned manufacturing businesses. In sectors which could be considered to be highly competitive, such as printing, the competitive nature of the domestic market provided incentives to seek (less crowded) overseas markets.

- Businesses in the primary sector, such as forestry and related areas, such as Agri-businesses, reported additional motivations for exporting including better risk management through operating in a diversified range of overseas markets.

- Entrepreneurial orientation and commitment to overseas markets can be a critical factor in a decision to enter overseas markets. Businesses may be in competitive sectors and have the potential to export, but there are risks and liabilities of engagement in export activity, hence it still requires entrepreneurial and management commitment, given the associated risks of international activity (such as greater uncertainty and lack of knowledge of overseas markets). The interviews confirmed the importance of such commitment as precursor to a business’s engagement in international activity. Factors that were important in determining such positive orientation and commitment included previous overseas experience, client enquiries and relocation of clients overseas.

- A range of internationalisation activity was reported from the businesses interviewed, including overseas production, overseas sales and overseas purchases. Whether a business was involved in overseas production was influenced by some of the factors that we have mentioned, including the nature of their product, freighting costs and the appreciation of the exchange rate. However, a strategic investment overseas also had advantages in meeting overseas regulations and through acting as a launch pad to enter additional overseas markets. The importance of such factors varied dependent on individual company sectors, product and markets, but we comment that what seems to be important for manufacturing companies is the ability to invest in a strategic presence as well as ensure quality of supply. It is also apparent that the interaction between an overseas presence and overseas sources could lead to additional market opportunities for those in high value niche product areas.

- Networks and trusted relationships were an important determinant of a business’s ability to develop internationalisation activities. Opportunities to internationalise may arise through a combination of factors mentioned above such as entrepreneurial motivations and a desire to grow a business and move from crowded domestic markets. However, it is important to have established networks and trusted relationships with contacts to exploit such opportunities.
- A significant number of companies were active in establishing subsidiaries to exploit overseas markets, or outward foreign direct investment (ODI), including both manufacturing and service sector companies. It was likely to be undertaken by high intensity exporting companies in their major overseas markets and could represent both short term and long term commitments. Taking a dynamic view of exporting, ODI could be seen as a longer term outcome of the internationalisation process. ODI could also exist where companies sought to source production overseas. This is particularly the case with NZ manufacturing companies in traditional sectors such as textile and clothing production, although this may be undertaken through joint venture and trusted partner arrangements rather than direct investment in capacity.

- The decision to internationalise can be seen in a dynamic capability thematic framework. This also helps to understand the impact of FDI on international capability of NZ businesses. In the majority of cases, NZ businesses undertake internationalisation through a careful staged approach. For individual businesses, the interrelationship between their markets, their product or service and their management or entrepreneurial commitment provided the set of circumstances that would determine engagement or otherwise in international activity.

- FDI for New Zealand businesses is an important phenomenon. Companies that were subsidiaries of foreign owned MNCs enjoyed varying degrees of autonomy, but FDI could be crucial in the context of dynamic resource capabilities and in entering new export markets. In some cases, FDI led to additional export markets and subsidiaries could benefit from additional resources.

- An emerging phenomenon is the participation in Global Value Chains (GVCs), where companies participate through their product being part of a global supply chain. These supply chains varied in complexity, but they were important for a significant number of manufacturing companies, particularly those that were MNC owned. Strategic decisions were taken globally, although NZ subsidiaries could still secure a niche reputation even within complex GVCs.

- In undertaking exporting, New Zealand-owned manufacturing businesses face a range of challenges that can vary with the nature of their product, with distance and with the nature of the destination market. We found that the cost, time and availability of freight were all important factors, which in some cases limited the business’s ability to penetrate new overseas markets. These factors, of course, partly account for the predominance of Australia as an overseas destination market for NZ manufacturing businesses (Statistics NZ, BOS 2011). Such challenges could be overcome with the more distant markets such as USA and Europe, but only if the business was in a strong market position with a strong demand for its product.

- Developing an overseas market requires commitment of time and resources to be successful, hence the importance of entrepreneurial and management commitment. Respondents were able to comment on the critical nature of this factor to ensure success which required up-front investment in time and resources. Indeed it can be an explanatory factor behind why some firms withdraw from overseas markets, because of a lack of time or resources. Having the right person, perhaps dedicated to international development as a key role in the business and willing to spend time travelling overseas was a critical factor for successful development of export activity and overseas markets. Difficulties in recruitment of such individuals was found to be a limiting factor, especially with NZ-owned manufacturing companies seeking to
recruit such experience and skills in individuals in New Zealand, requiring considerable time before a person of suitable calibre could be recruited.

- In some cases, an additional factor requiring investment was the need to educate an overseas market, perhaps where the product is new to the market or technology-based, requiring further investment in time and resources.

- Other challenges in developing overseas markets could be considered to be financial such as those associated with market duties and tariffs, increased lead times for payment and the financial risks associated with fluctuating exchange rates. Tariffs in some overseas markets were found to be restrictive for some companies affecting the scope of their international activity. Differences in regulations in overseas markets were also reported as an important challenge reinforcing the need for adequate preparation and investment to achieve success in export markets. The well-known funding and liquidity issues associated with the longer lead times for businesses engaged in export activity, did not significantly prevent the development of overseas markets, but rather illustrated the need for businesses that are seeking to enter export markets to be well prepared with a sound financial base and with a good banking relationship.

- There is no doubt that the continued increase in the value of the NZD in recent years has affected some NZ businesses' ability to export, maintain and develop overseas markets. At the time the interviews were undertaken, the NZD was at a near high of 1 NZD = 0.80 USD and was continuing to appreciate. However, in most cases companies were able to manage appreciation and fluctuation in the short term, although such appreciation did limit the scope of export activity for some companies where their markets are price sensitive. A more subtle effect was noticeable through strategic changes in business behaviour, with evidence that some companies had brought forward plans to produce abroad as a longer term strategic response. We comment that this represented a strategic response to the appreciation, over time, of the NZD.

  o In summary, we comment that the appreciation of the exchange rate since 2008 has been a major challenge for companies, but some had adjusted and others were making strategic responses that involved cost reduction methods and sourcing alternative means of production. Manufacturing companies with long lead times were most affected, but were also involved in longer term adjustment strategies.

- Of course, companies exporting to our major overseas trading partner, Australia, are less affected; rather such companies enjoyed advantageous trading terms with cost advantages reported by companies in some sectors. However, even with such cost advantages in the Australian market, it was still important for companies to strategically invest in a local presence for successful export development.

- The report considered service sector companies as a special group. Relying more on personal relationships, networks and knowledge base, such companies are more likely to need to establish a domestic market and are more likely to have less export intensity than manufacturing companies. Cultural factors were important in decisions to enter export markets. Hence, they are likely to be predominantly in overseas markets that are similar to New Zealand, especially the UK and the USA, attracted partly by similarities in culture and those where English is a first language. With service sector companies, outward FDI seems to be relatively rare. We suggest this could be because such companies become targets for overseas based MNCs seeking a way into the NZ market, since they benefit from having a subsidiary operating in New Zealand. The key to
understanding the internationalisation behaviour of such companies lies in the importance to them of personal relationships and the improvements in their knowledge base.

- There is an important relationship between competitiveness, international activity and innovation. An ability for NZ-owned businesses to compete successfully in overseas markets is critical to our economic performance and GDP per capita. We report that the sources of competitive advantage lay in a range of factors which included: the nature and superiority of product, ability to compete through lower costs, through quality, greater knowledge and the existence of IP. We report, however, that reliance solely on cost advantages is relatively rare and that the role of innovation is critical to maintain competitive advantage. We comment that there is a cycle of open innovation from involvement in overseas markets, reinforcing company productivity.

- To successfully exploit overseas markets, businesses need to be able to build upon experience and lessons learned. We indicate that it is important for businesses to be able to absorb lessons from both successful and unsuccessful strategies in overseas markets. It can take time to understand the requirements of overseas local markets. For example, customers overseas may have different expectations and requirements from those in domestic markets and expectations may vary between different overseas markets. We comment that such issues and reported experience from our respondent companies illustrates the need for a careful and planned approach to undertaking (new) internationalisation activity, sometimes requiring a high degree of perseverance to overcome the challenges in some overseas markets.

  o A perfectly valid outcome may be disengagement from some overseas markets as experience is gained and lessons are absorbed. It may lead to a revaluation of opportunities and a shift in focus to different overseas markets. We report that such activities reflect the importance of entrepreneurial motivation, changing economic circumstances, adequate preparation and planning and the importance of having trusted relationships with contacts and adequate networks in overseas markets.

- In New Zealand there is considerable support and advice available to businesses seeking to export and enter international markets, through a number of agencies and Government bodies. However, we report that businesses in our sample relied predominantly on their own business and industry networks to source information and advice in relation to internationalisation activities, these included sources such as business peers, professional advisers, industry bodies and other contacts such as clients and distributors.

- The most important source of advice from the public sector was New Zealand Trade and Enterprise (NZTE). Although the majority of our respondents were aware of the services offered by NZTE, most had not used them. In some cases this was due to a perception that they would be too small to meet NZTE’s requirements (perhaps through the nature of target markets and ambitions). However, in some cases, notably growing companies with specific target overseas markets, the support and advice from NZTE had proved to be “significant” and important to their capability to exploit overseas markets.

- However, from our evidence, we conclude that there is a support gap for small NZ-owned businesses that do not meet the criteria set by NZTE. In addition there seems to be a perception issue with such smaller firms on the value of such support. We suggest that a suitable mechanism be examined for such channels of advice and support, perhaps through the raising of awareness of the role of Regional Development Agencies and their network
of advisers and mentors. This could be seen as additional ‘light-touch’ support for a specific type of exporter which usefully add to existing provision. The KEA network is already useful, some companies may be able to benefit through additional direction that could lead to additional utilisation to provide a source of trusted contacts that small companies need to enter overseas markets.

- Moving to areas which could be considered to concern more general economic policies, rather than specific business support policies, these were concerned with New Zealand’s business environment, observations on policy and respondents’ future plans.

  o Most comments on NZ’s business environment were very positive, particularly on the regulatory environment. We comment that New Zealand’s regulatory environment was particularly positively rated by respondents with experience in a range of different overseas markets. New Zealand’s reputation was important in a number of areas, the ‘clean and green’ reputation overseas was important, of course, for Agribusinesses. However, outside this sector, respondents considered that the reputation of their brand was ultimately more important than New Zealand’s reputation. The importance of bio-security varied between different businesses, creating additional costs in some cases, but benefits in others. A more difficult area to pin down is NZ’s perceived reputation overseas for innovative capacity, which in the experience of some respondents was perceived as being relatively low, i.e., ‘slow and backward’. However, in other areas where quality was important, such as engineering, NZ was considered to have a good reputation.

  o Observations made on policy were largely related to developments in Free Trade Areas (FTAs). Respondent comments were varied and depended on individual business circumstances. For example, low value manufacturers reported that FTAs were beneficial through the reduction of tariffs in overseas markets and would welcome continued pursuit of such policies, whereas high value manufacturers were mostly unaffected by the existence of duties and tariffs. In general there was support for the continued pursuit of FTAs (with additional countries) with respondents recognising the benefits for general trading conditions in New Zealand.

  o Future plans of respondents were found to depend on a range of factors that varied in importance across individual businesses, but reflect some of the findings in this report. The predominant approach of entering new overseas markets for most of our respondents was a carefully managed staged approach that depended on the importance of initial contacts, networks and relationships. We indicate that the following factors are important in determining businesses’ future internationalisation activities: similarity of language, culture and regulatory systems, existing networks and trusted relationships, ease of market access, physically-related issues such as freighting and distance, knowledge and familiarity with the market, the infrastructure in the overseas market and balancing market size with internal business capacity.

  o These are indicators of where business and support advice may focus on in helping NZ-owned businesses to achieve their goals of greater internationalisation activity.


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