Chapter 3: Literature review

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Introduction:
The previous chapter provided an overview of the world and Indian floriculture sector. The objective of this study is to find out whether Indian floriculture industry is sustainable and can it compete in the international markets. This chapter provides the theoretical framework and definitions which are relevant to this research. The objective of this literature review is reviewing some literature and theories which relevant to the research of this thesis. In this chapter a literature study will be done to bring out the theories related competitive advantage to be used as a base for the research. The literature review provides a theoretical framework that is used as a basis for executing the research and is presented in the following chapter.

3.1 Theoretical framework
The comprehensive review of floriculture sector presented in previous chapter points out that the worldwide floriculture sector is competitive. Barriers to both entering and exiting the sector are low. The costs of switching between suppliers or buyers and between flower varieties are also low. The flower production in most developing countries is destined for developed countries: the domestic market in developing countries is negligible. This put the challenges of the floriculture sector in the theoretical area of internationalization and competitiveness. The sustainability of the industry is therefore determined by the competitive advantages and the strategic behavior. The theoretical framework that is outlined in this chapter is based on a literature search that provided input from a number of authors that have contributed to the field of strategic management. The mixture of input from the different authors provides a comprehensive framework for executing a strategic analysis that contributes to answering the main research question.

One group of authors, Boardman, Shapiro and Veining (2004), advocate that a strategic analysis should consist of three main analyses: the external analysis, the fulcrum analysis and the solution analysis. The framework developed by Boardman et al. (2004) outlines a number of detailed and sequential research steps that enable a researcher to execute a comprehensive strategic analysis that can be used to solve a strategic issue. In addition to Boardman et al. (2004) there are a number of other authors that provide input for executing a strategic analysis, including: Porter (1980; 1985), Austin (1990) and Johnson, Scholes and Whittington

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The objective of doing external environment analysis in this thesis is finding out the opportunity and threat to the floriculture sector in India and Pune. The understanding of external environment helps to analyze the competitive advantage provided and to device competitive strategies to help grasp the opportunities and prevent the threats. The external analysis will then analyze the focal firm’s external environment as suggested by Boardman et al. (2004). The external environment could be divided into macro-environment and micro-environment. To help identify the strategic behavior it is necessary to conduct macro and micro analysis. To analyze the micro external environment Boardman et al. (2004) and Johnson et al. (2008) suggest using the five forces framework developed by Porter (1980). Austin (1990), adds four influential macro factors to Porter’s original five forces framework. The four factors include: economic, political, cultural and demographic factors. They are similar to the factors in the PESTEL-framework (political, economical, social, technological, ecological and legal) developed by Johnson et al. (2008). Hence PESTLE model analysis is used to scan the macro-environment, which considers the Political / legal environment, economic environment, social/cultural environment, technological environment, and ecological/physical environment. These important forces jointly form the opportunities and threats to a company in its industry. (Jobber, 2004)

Furthermore, Johnson et al. (2008) note that a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis is a useful tool to generate strategic options and assess the future course of action of a company. The SWOT analysis is a technique which is credited to Albert Humphrey (1969). It is a transparent planning instrument that can identify important problem areas for a company. It also enables a company to learn about the current situation and reflect on what can be done to improve the current situation (Sorensen, Vidal, & Engström, 2004). The objective of using SWOT analysis in this dissertation is providing a list of “strength, weaknesses, opportunities, and threats”. After analyzing the external and internal environments, the firm is able to decide which competitive strategies should be used to achieve its competitive objective. The competitive strategies could be used to “exploit opportunities in the firm’s environment with the firm’s strength, and neutralizes threats in the firm’s environment while avoiding the firm’s weaknesses” (Barney, 2007, P12).

PEST is rarely applied alone, as the information provided is more useful while complementing another analysis. Combined with SWOT, for example, PEST helps to
understand the risk associated with launching a particular product into a market (Schildhouse, 2006).

The third and final part of the situational analysis as described in the generic framework developed by Boardman et al. (2004) is the current strategy analysis. It analyzes the focal firm’s current strategy for judging and taking advantage of the opportunities within a market.

The competitive strategies are used to gain competitive advantage, which aims to outperforming other firms in an industry, and earn a higher rate of profit than the industry norm. (Barney, 1991) For pursuing a competitive advantage Porter (1980, 1985) identified three generic strategies: a cost leadership strategy, a differentiation strategy and a focus strategy.

PESTLE, Porter’s Five Forces, and SWOT all utilize basic frameworks for reviewing a situation (Chapman, 2005). The objective of literature review in this thesis is reviewing some literature and theories which relevant to the research of this dissertation. Figure 3.1 provides the theoretical framework and a list of literature and theories, which will be covered in this chapter.

![Fig 3.1 Theoretical framework and Outline of this chapter](image)

Hence the next sections of this chapter provide an literature review of PESTLE, Porters Five force model, SWOT and Porters generic strategies. This is followed by a brief review of Internationalization to give a better understanding of the research objectives.
3.2 PESTLE Analysis

Tools and techniques for environmental scanning were firstly discussed by Aguilar (1967) who defined it as a process that seeks “information about events and relationships in a company’s outside environment, the knowledge of which would assist top management in its task of charting the company’s future course of action” (Fahey & King, 1977). This external environment can be divided into the operating environment – the suppliers and other interest groups, with which the firm deals, and the general environment – the national and global context of social, political, regulatory, economic and technological conditions (Thomas, 1974). Shortly after its publication, Arnold Brown for the Institute of Life Insurance (in the US) reorganized it as ‘STEP’ (Strategic Trend Evaluation Process) as a way to organise the results of his environmental scanning.

Thereafter, this ‘macro external environment analysis’, or ‘environmental scanning for change’, was modified yet again to become a so-called STEPE analysis (the Social, Technical, Economic, Political, and Ecological taxonomies). In the 1980s, several other authors including Fahey, Narayanan, Morrison, Renfro, Boucher, Mecca and Porter included variations of the taxonomy classifications in a variety of orders: PEST, PESTLE, STEEPLE etc. The term PESTLE is particularly popular on HR and introductory marketing courses in the UK. Others favor PEST, STEP or STEEPLE. The growing importance of environmental or ecological factors in the first decade of the 21st century have given rise to green business and encouraged widespread use of an updated version of the PEST framework.

As can be understood, PESTLE analysis concentrates on the general environment. The external environment of an organization exists of the general environment and the task environment. To analyze the external environment of a company, it can be useful to conduct a PESTLE analysis. A PESTLE analysis is a way to analyze the general external environment of an organization (Morden, 2007, p.94). Every organization has an external environment. The external environment is quite important because it is the environment in which a company operates. PESTLE analysis is a useful tool for understanding the “big picture” of the environment in which industry is operating, and environmental understanding will bring the advantage of the opportunities and guide to minimize the threats. PESTLE components are Political, Economic, Social, Technological, Legal, and Environment (Rapidbi, 2007)
PESTLE analysis is used to identify forces in the macro-environment that are affecting the business at present and are likely to continue to affect the business in the future (Haberberg and Rieple 2008). Macro-environmental analysis is interested in factors in the wider environment that influence the demand for the product or service offered by a company; demand for the product or service; the manner in which the product or service is distributed; the price that is charged for the product or service; as well as the manner in which organizations compete with each other (Haberberg and Rieple 2008). The task environment of a firm is the environment of an organization that directly affects the organization. The customers, suppliers, competitors and labor market of a firm belong to the task environment (Daft, 2003, p. 80). PESTLE analysis is important due to the following reasons:

• PESTLE analysis helps to assume the realities of the business environment (Jobber 2007)
• PESTLE analysis the organizations which are doing highly with the powerful forces which change the ongoing business environment.
• The advantage of the PESTLE analysis , the organization would be successful in their operations (Kotler, Armstrong 2004)
• PESTLE analysis helps the company to take the action for the reasons beyond its control.

A recent study which conducted by Jarzabkowskiet al., (2011) regarding the use of strategic management tools which included PESTLE among the group of tools that were most widely used by practitioners in the world of business.

PESTLE components are Political, Economic, Social, Technological, Legal, and Environment (Rapidbi, 2007)

3.2.1 Political factors:

Political environments in a company’s home country and the countries in which it does business are important external influences on management. Political environments refer to public institutions (such as the government, government agencies, and government-owned businesses) and non-public institutions (such as environmental and other special interest groups that represent specific individuals or groups) (BARON, 1993). Political risks can be divided into macro and micro political risks. Macro political risks as a result of wars and
changes in government affect all companies operating in the target country. Changes in leadership and a country’s political system can even result in expropriation or confiscation, where the government seizes the assets of the company without compensation. (Wall Rees 2004, 136). The micro political risks in the country’s political environment affect only companies in certain industries, areas or ventures. An example of a micro political risk could be regulations and taxation imposed on companies working in a specific sector. (Wall&Rees 2004, 136.)

Political factor takes care of the government intervention in the business keeping in view the areas such as taxation labour and trade laws and taking into consideration the government stabilities government policy on economy and market ethics and trading agreements with the government. It also outlines the merits and demerit goods defined as the goods the government wants to provide/wants to be provided as well as those not to be provided. (Holbrook,1999). The political-legal environment has a huge influence upon the regulation of businesses, and the spending power of consumers and other businesses.’ Marketing decisions are strongly affected by developments in the political and legal environment. This environment is composed of laws, government agencies, and pressure groups that influence and limit various organizations and individuals (Kotler, 2004, P89). These refer to government policy such as the degree of intervention in the economy. What goods and services does a government want to provide? To what extent does it believe in subsidizing firms? What are its priorities in terms of business support? Political decisions can impact on many vital areas for business such as the education of the workforce, the health of the nation and the quality of the infrastructure of the economy such as the road and rail system.

3.2.2 Economic Factors:
Economic factors takes into consideration areas which can effect business operation and decision making. They include interest rates, taxation changes, economic growth, inflation and exchange rates. These include factors such as exchange rates(effects export and import of goods) interest rate(effects a company’s cost of capital),inflation rate (effects the company’s everyday running and use of goods and services such as transport)other factors include economics growth.(Jobber,2007)
These factors have major impacts on how businesses operate and make decisions. The economic environment that companies face can be divided into global economy and local independent economy. The concept of ‘World Trade’ includes the trade volume of the entire world, trade between nations, trade alliances, rules and regulations for international trade, nations own economic policies and organizations such as European Union, World Trade Organization and International Monetary Fund that control and support international trade.

WTO is in charge of introducing international trade laws and controlling the global markets. Financial environment includes all risks in the foreign transactions. These include financial risks, non-financial risk (political and foreign exchange risk). It is essential to minimize these financial risks as they can affect the whole internationalization process of the company. (Vahvaselkä 2009, 69.)

Exchange rates affect the costs of exporting goods and the supply and price of imported goods in an economy. One type of exchange rate risk is a translation exposure, which reflects the changes of value of the firm’s foreign assets being converted to home currency. (Smithson 1998, 1-14.) Sometimes companies want to sell their equity to foreign facility so that funds may be used for other purposes. The ability to find local buyers varies substantially among countries. (Daniels et al 2007, 427.) Fluctuations in commodity prices can result in substitute products to be more affordable to consumers than the company’s input products. Competition and conflicts can affect the general community price levels, thus affecting companies. (Smithson 1998, 1-14.)

3.2.3 Social Factors:

Social factor plays a vital role when it comes to the demand of the company’s products and services. The focus is on health consciousness, career attitudes, attitudes of people towards foreign goods and services, impacts of language etc. population growth rate and distribution has a direct influence on the labour cost of a company. (Kotler, Armstrong, 2004) Changes in social trends can impact on the demand for a firm's products and the availability and willingness of individuals to work. Social factors include the cultural aspects and include health consciousness, population growth rate, age distribution, career attitudes and emphasis on safety. Some important factors to consider are the availability and cost of skilled labor, age distribution, labor strikes and crime statistics. (Morrison 2002, 154.) The second consideration is culture and managing it. Culture is shared patterns of behavior that is
inherited in a society (Schneider&Barsoux 2003, 21). Culture affects a company’s operations in both macro level (elements in the social and cultural environment) and micro level (national pride, national identity and attitude towards foreign products). (Vahvaselkä 2009, 69.) Lastly, long-term orientation stands for the fostering virtues towards future rewards through thrift and persistence as short-term orientation means fostering of virtues related to past and present and only satisfying social obligations (Hofstede 2005, 210).

3.2.4 Technological Factors:
New technologies create new products and new processes. Technology can reduce costs, improve quality and lead to innovation. These developments can benefit consumers as well as the organizations providing the products. Technological factors include technological aspects such as R&D activity, automation, technology incentives and the rate of technological change. They can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation. Technology transfers have been a crucial process in industrial growth and global integration. This is a process where technology is transferred from one country to another, creating industrial growth in both countries. (Morrison 2002, 301.) Changes in the technological environment affect both the buyers and sellers. Namely, the purchasers want better products and the company can develop their means of production as well as operation. (Vahvaselkä 2009, 69.) Technological change can involve new processes of production, resulting in increased production volume and capacity. Technological factor a major driving force behind globalization and market competition. Technological factor takes into consideration whether the cost of manufacturing can be reduced with the use of advance technology, improvement is services such as internet banking and mobile communication. Technology can have great impacts on time driven services and also lead to new innovations. (Carson & Gilmore, 2000)

3.2.5 Legal Factors:
Legal factors are related to the legal environment in which firms operate. Law is the supreme command of any nation/place. The company has to look in to and take care of carrying out their business operations well within the limit set by law. These include distribution laws, health laws, employment law etc. (Palmer, 2004) The introduction of age discrimination
and disability discrimination legislation, an increase in the minimum wage and greater requirements for firms to recycle are examples of relatively recent laws that affect an organisation's actions. Legal changes can affect a firm's costs (e.g. if new systems and procedures have to be developed) and demand (e.g. if the law affects the likelihood of customers buying the good or using the service). Corruption may include requirements of payments to win a contract or receive services from the government. In countries with low legal transparency and high corruption, government employees might seek their own or their countries interest and so might delay or stop foreign business from operating. (Daniels et al 2007, 422-423.) Companies need to be aware of the risks involved in the legal environment and is often advisable to have a reliable local partner and an attorney who can deal with the legal issues and bureaucracy. (Morrison 2009, 183.)

3.2.6 Environment Factors:

Environmental factors include ecological and environmental aspects such as weather, climate, and climate change, which may especially affect industries such as tourism, farming, and insurance. Environmental factors include the weather and climate change. Changes in temperature can impact on many industries including farming, tourism and insurance, growing awareness of the potential impacts of climate change is affecting how companies operate and the products they offer, both creating new markets and diminishing or destroying existing ones. With the increasing awareness and eco drive campaigns by the public, the companies have to look into the impact of their company on the environment and climate change, and determine the use of existing practices and policies with in the organization and beyond.(Kotler, Armstrong 2004). The International Organization for Standardization (ISO) has developed environmental management standards, which companies can use to create a competitive advantage. (Tulinen 2007, 16.) One of the best known international agreements is the Kyoto agreement that limits the emissions for each country inside the agreement. (Morrison 2002, 360.) Consumers often demand products and production methods that support sustainable development. Recyclability of the products is one way of measuring the environment-friendliness of the company. (Morrison 2002, 355-357.)
3.3 Strategy:

Strategy is first and foremost a broad and complex concept. In an attempt to provide a definition, Porter (1996) states: “Strategy is the creation of a unique and valuable position, involving a different set of activities.” Porter (1996), p. 68 The essence of strategic positioning is to choose activities that yield superior profitability because they are different from rivals’ and thus create a sustainable competitive advantage. Note that a competitive advantage is not necessarily enduring, which is why strategy must be distinguished from operational effectiveness (OE). Both elements can generate competitive advantage, which improves performance, but OE is relatively easy to imitate and, consequently, the competitive advantage risks eroding. In fact, Saloner, Shepard & Podolny (2001) mean that the major threat to the sustainability of a competitive advantage is that rivals can diagnose and duplicate or make obsolete the competitive advantage. Saloner, Shepard & Podolny (2001), p. 65

Strategy encompasses not just the cumulative policies and resources of a firm but the common thread of logic that links them together into a coherent and consistent whole (Andrews, 1971; Ansoff, 1965). Whilst there are numerous definitions of strategy, the following demonstrates the importance that has historically been placed on fit between resources, strategies, environment (opportunities/threats) and performance;

“a strategy describes the fundamental characteristics of the match that an organisation achieves amongst its skills and resources and the opportunities and threats in its external environment that enables it to achieve its goals and objectives” (Chrisman et al., 1988, p. 414).

The original term strategy derives from the Greek word, strategos, and was originally used in the military arena. However, “businesspeople have always liked military analogies, so it is not surprising that they have embraced the notion of strategy” (Harvard Business Essentials, 2005, p.xii). Strategy is a “plan that aims to give the enterprise a competitive advantage over rivals through differentiation” (Harvard Business Essentials, 2005, p. xiv), as well as, as Michael Porter suggests, a plan focused on “positioning… [and] operational effectiveness” (1998, p. 73).

In more simple terms, strategy links an organization’s current purpose and activity to achieving that organization’s goals for the future. The importance of strategic management
emerged in the 1950s when Selznick (1957) introduced the need to bring an organization’s ‘internal state’ and ‘external expectations’ together for creating goals and plans. A key part of strategy is the implementation of it. While some scholars argue that implementation of strategy is a separate notion all together, for the purpose of this study, implementation of a strategy is considered part of strategic planning as a whole.

Strategy types have been identified in a number of several industries, e.g. Galbraith & Schendel (1983) in consumer products and industrial products, Hatten et al (1978) in brewing, Newman (1978) in chemical process, Fiegenbaum & Thomas (1990) in U.S. insurance industry). However, Miles & Snow’s (1978) and Porter’s (1980) generic strategic typology classification schemes have come forth as the most popular and widely used. Their appeal springs from the fact that generic strategies, by definition, are not limited to any particular industry or context. In particular Porter’s (1980) model of generic strategies has outperformed all other contributions in terms of the impact on business-strategy formulation.

After analyzing the external and internal environments, the firm is able to decide which competitive strategies should be used to achieve its competitive objective. The competitive strategies could be used to “exploit opportunities in the firm’s environment with the firm’s strength, and neutralizes threats in the firm’s environment while avoiding the firm’s weaknesses” (Barney, 2007, P12).

The competitive strategies are used to gain competitive advantage, which aims to outperforming other firms in an industry, and earn a higher rate of profit than the industry norm. (Barney, 1991) The essence of strategic positioning is to choose activities that yield superior profitability because they are different from rivals’ and thus create a sustainable competitive advantage. Note that a competitive advantage is not necessarily enduring, which is why strategy must be distinguished from operational effectiveness (OE). Both elements can generate competitive advantage, which improves performance, but OE is relatively easy to imitate and, consequently, the competitive advantage risks eroding. In fact, Saloner, Sheppard & Podgorny (2001) mean that the major threat to the sustainability of a competitive advantage is that rivals can diagnose and duplicate or make obsolete the competitive advantage.
3.4 Porters Generic Strategies

Porter’s generic strategy theories (Porter, 1980; 1985) gained huge popularity in the literature as the predominant theory of how a firm competed in the marketplace, and how it was able to achieve a competitive advantage through competing on the basis of either cost, differentiation or focus. Porter saw the value chain of activities as an integral part of how a firm came to achieve a competitive advantage (Porter, 1985). His model prescribes where in the industry a firm should position itself, the choice of positioning determining whether the firm’s profitability is above or below the industry’s average. Porter’s generic strategies have generally been found to be effective in explaining firm behavior with extensive support in the strategy literature. The smaller firm is most often prescribed to compete on a focus strategy, especially a differentiation focus strategy as it does not have the necessary economies of scale to compete on cost (Beal, 2000; Kean et al., 1998)

Porter is considered by many as the most influential strategist in the field of business-strategy. Eng (1994) for example estimates that “the arguments underlying the generic strategies advocated in Porter’s, Competitive Strategy (1980) have influenced much of the current thinking in strategy formulation.” In effect, Porter’s model has been widely tested (e.g. Hambrick, 1983; Dess & Davis, 1984; Akan et al, 2006; Reitsperger et al, 1993; Calingo, 1989) but despite criticism and efforts to modify, expand or combine the strategy typology with others’ (i.e. Miles & Snow’s (1987) typology), the original model has remained the most commented, analyzed and tested contribution. In particular Porter’s (1980) model of generic strategies has outperformed all other contributions in terms of the impact on business-strategy formulation.

It is has been praised for being easy to understand, appropriately broad without being vague, and building upon previous findings. Its appeal springs from the fact that generic strategies, by definition, are not limited to any particular industry or context. The model shall be presented more thoroughly next.
Porter (1980; 1985) outlined that there are only two types of competitive advantage a firm could have, overall cost leadership or differentiation, and these determine a firm’s ability to cope with industry forces better than its rivals. These two types of competitive advantage can be achieved in three ways, hence the three generic strategies of: cost leadership, differentiation and focus. Cost leadership and differentiation involve competing in a broad range of industry segments while focus involves competing in a narrow segment. All three strategies have the potential to result in above-average profits; however, all three strategies may not be equally suitable for a firm. The reason is that the three strategies differ on a number of dimensions and pose different requirements, for example in terms of resources, skills, organizational arrangements, control procedures, incentive systems and management style. Profitability may vary depending on the wellness of fit between the firm and the selected strategy, which make the decision of which strategy to adopt key to the benefits of strategic planning and requires that the choice be well founded.

The generic strategies can be considered in terms of an absolute market position, or as a strategic dimension with various levels of strategic emphasis along a continuum. Porter suggests that a firm should be better to concentrate on one of these strategies, but not mix all of them together. That because different generic strategies demand different resource base. If
a firm intends to combine different generic strategies, it will fall into “stuck in the middle” position and will have less power and capabilities to compete effectively (Wickham, 2002, P 57; David Jobber, 2004, P688)

3.4.1 Cost leadership strategy

The companies that attempt to become the lowest-cost producers in an industry can be referred to as those following a cost leadership strategy. Cost leadership strategy targets at cost-conscious or price-sensitive customers. Firms sell the products either at average industry prices to earn a profit higher than the competitors, or below the average industry prices to achieve market share. Companies following this strategy place emphasis on cost reduction in every activity in the value chain. It is important to note that a company might be a cost leader but that does not necessarily imply that the company's products would have a low price. In certain instances, the company can for instance charge an average price while following the low cost leadership strategy and reinvest the extra profits into the business (Lynch, 2003). Cost leadership strategy is reducing the economic costs (such as production, distribution and marketing costs) below all of the competitors. (Barney, 2007) Thus, the firm is able to gain more profit margins, or could provide a competitive price to attract more customers for high sales. (Jobber, 2004) In order to adopt cost leadership strategy without forgoing profit, a firm should have the internal strengths, such as:

• Differential access to factors of production
• Access to the required capital for a significant investment
• High level of expertise and skills in efficient manufacturing process
• Technological advantage
• Accurate demand forecasting combined with high capacity utilization
• Economies of scale
• Sustained access to inexpensive capital
• Products designed for efficient manufacturing
• Efficient distribution channels Barney & Hesterley (2006) mean that there are six main cost advantages, or, sources of cost advantages for firms that successfully adopt cost leadership: 1.Size differences and economies of scale, 2.Size differences and diseconomies of scale, 3.Experience differences and learning-curve economies, 4.Differential low-cost access to productive inputs, 5.Technological advantages independent of scale, and 6. Policy choices. Further, the authors explain that the ability of a valuable cost leadership strategy to
create a sustainable competitive advantage is conditional upon the strategy being rare and costly to imitate.

Organizing to implement a cost leadership strategy requires particular consideration to the organizational structure, management controls, compensation policies, and implementing cost leadership strategies. The organizational arrangements and implementation tools should not only fit but reinforce the strategy. Porter (1980) has divided requirements of overall cost leadership strategy into “commonly required skills and resources” and “Common organizational requirements”. Commonly required skills and resources when implementing overall cost leadership are sustained capital investment and access to capital, process engineering skills, intense supervision of labor, products designed for ease in manufacture, and low-cost distribution systems. Common organizational requirements constitute of tight cost control, frequent, detailed control reports, structured organization and responsibilities, and incentives based on meeting strict quantitative targets.

3.4.2 Differentiation strategy

This strategy seeks to win certain customer group by offering differentiated products or services that are perceived to be better or different from competitors' products or services. So that the perceived uniqueness may bring high customer loyalty and also the firms are able to charge a certain amount of premium. Differentiation consists in differentiating the product or service offered by the firm, in other words, creating something that is perceived industry-wide as being unique. Differentiation strategy is used for a firm to be unique in its market, and aims to obtain a price premium by its differentiation, which is not easily copied by its rivals. (Porter, 1985; Jobber, 2004) It is often associated with “a premium price, and higher than average cost for the industry as the extra value to customers often raises costs” (Jobber, 2004, P687). If a firm has the following internal strengths, it will be more appropriate to adopt this strategy:

- Corporate reputation for quality and innovation
- Excellent customer service and management skills
- An efficient dealer network and other unique dimensions
Differentiation may be achieved in various ways, for example through design, brand image, technology, features, customer service, and dealer network. Bases of differentiation may be sorted into three categories. Firstly, to implement differentiation, a firm may focus directly on product (or service) attributes, i.e. product features, product complexity, timing of product introduction, or location. Secondly, a firm may focus on the relationship between itself and its customers, for example through product customization, consumer marketing and product reputation. Finally, differentiation may be implemented by focusing on the linkage within or between firms, which includes linkage within functions of a firm, linkage with other firms, product mix, distribution channels and service support. Ideally, the firm should differentiate itself along several dimensions.

Barney & Hesterley (2006) argues that, “product differentiation is ultimately an expression of the creativity of individuals and groups within the firms. It is limited only by the opportunities that exist, or that can be created, in a particular industry and by the willingness and ability of firms to creatively explore ways to take advantage of those opportunities. This strategy is applicable in the non-price sensitive saturated market, otherwise, it will be associated with the risks of competitors’ imitation and changes in customers’ preferences or tastes. Differentiation has many advantages for the firm which makes use of the strategy. Some problematic areas include the difficulty on part of the firm to estimate if the extra costs entailed in differentiation can actually be recovered from the customer through premium pricing. Moreover, successful differentiation strategy of a firm may attract competitors to enter the company's market segment and copy the differentiated product (Lynch, 2003).

3.4.3 Focus Strategy:
It concentrates on a narrow market segmentation and with that segment attempts to achieve relatively broad either a cost leadership or differentiation. In general, firms with a focus strategy often have a high degree of customer loyalty. The focus strategy aims at serving a particular target or segment of the industry well, as opposed to both overall cost leadership and differentiation strategies seek to achieve their objectives industry-wide. Thus a focus strategy sets out to achieve a low cost or differentiation position, or both, from the perspective of its narrow market segment. Porter (1980), p 38-39. Porter initially presented focus as one of the three generic strategies, but later identified focus as a moderator of the two strategies. Companies employ this strategy by focusing on the areas in a market where there is the least amount of competition (Pearson, 1999). Organizations can make use of the focus strategy by
focusing on a specific niche in the market and offering specialized products for that niche. This is why the focus strategy is also sometimes referred to as the niche strategy (Lynch, 2003).

Focus strategy could be divided into cost focus strategy and differentiation focus strategy. “This strategy is quite different from the others because it rests on the choice of a narrow competitive scope within an industry” (Porter, 1985, P15).

- Cost focus strategy is used by a firm to seek a cost advantage with one or a small number of target market segments. (Jobber, 2004, P688)
- Differentiation focus strategy is used to seek differentiation advantage with one or a small number of target market segments. (Jobber, 2004, P688)

No matter in adopting a narrow or broad focus strategy by offering low prices or differentiated products or services, the firm should depend on the needs of selected segment and its resources and capabilities. A successful focus strategy can make a firm be able to tailor a broad range of product or service development strengths to a relatively narrow market segment. The downside of the focus strategy, however, is that the niche characteristically is small and may not be significant or large enough to justify a company's attention. The focus on costs can be difficult in industries where economies of scale play an important role. There is the evident danger that the niche may disappear over time, as the business environment and customer preferences change over time (Lynch, 2003).

Firms can choose from one of the three generic strategies to compete in the marketplace, regardless of the context of industry (Porter, 1980). As far as it concerned, it is of importance to realize that generic strategies are the ways to gain competitive advantage and are closely related to the capabilities and resources the company posses and uses. Nevertheless, each generic strategy has its own risk. In addition, although these generic strategies are not necessarily compatible with one another, firms are able to succeed at multiple strategies with creating separate business units for each strategy. Whereas to be successful in the long term, Porter (Porter, 1980) argued that a firm must select only one of these three generic strategies, otherwise the firm will be stuck in the middle and will not achieve a competitive advantage by selecting more than one single generic strategy. However in research it has been found that on average ‘stuck in the middle’ firms can be more profitable (Miller and Dess, 1993), or that a balance must be struck with how differentiated the firm is (Deephouse, 1999).
The strategy of choice is related to the order of market entry with pioneers more likely to pursue a differentiation strategy, and followers a cost leadership strategy (De Castro and Chrisman, 1995). Campbell-Hunt (2000) supported Porter’s theories in those competitive dimensions of cost and differentiation played a high level role in discriminating between the many possible designs of competitive strategy. However he found no evidence to support that any generic competitive strategy was more profitable than any other.

Briefly, the generic strategies can help a firm to create its competitive advantage. The determination about “which strategy should be used” should base on some factors, such as: the environment of the industry (relation between 5-force model and generic strategies is shown in Appendix 1), firm’s internal resource, and the customer need.

By having a strategy, a firm can efficiently manage costs of operations, effectively execute projects and subsequently have superior market and economic intelligence as well as achieving competitive advantage. Barney (1991) suggests that firms obtain sustained competitive advantages by implementing competitive strategies that exploit their internal strengths, through responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses.

3.5 Competitiveness

The concept of competitiveness first emerged in Charles Darwin’s “competition by natural selection, survival of the fittest” theory. Buckley et al. (1988) first proposed the academic research of competitiveness. They noted that competitiveness was the precedence of competition, a management process, and a result of competition. Francis and Tharakan (1989) classified competition into 3 levels, enterprise, industrial, and national competition. Porter (1990) proposed in his Diamond model that national competitiveness meant to indicate that the business have the ability to compete in the competitive markets. Meanwhile, industrial competitiveness is concerned with whether a certain industry of a country has advantages in the global market. And in terms of business segment, companies can create relative competitive advantage and possess unique resources (Hsu, 2000). Competitiveness has different implications when applied to different levels and the common purpose is to achieve a beneficial position through the establishment of competitive advantage (Man et al., 2002). As the competitive environment becomes more turbulent, the most important issue the sellers
face is no longer to provide excellent, good quality products or services, but also to keep loyal customers who will contribute long-term profit to organizations (Tseng, 2007). Researches related to competitiveness have extended from countries (Porter, 1990; Makhija, 1993; Leeway and Murtha, 1994; Keith and Lance, 1997; Moon et al., 1998), cities (Hu, 2004; Kresl, 1995; Begg, 1999; Rogerson, 1999), urban tourism (Crouch and Ritchi, 1999; Kim, 2000; Kozak, 1999; Gooroochurn and Sugiyarto, 2005) to various industries (Man et al., 2002). The different objectives refer to the greatly different structure of competitiveness.

Nowadays, enterprises have entered the era of low profit and increasing competition. And they also behave more and more similar to each other. Competition is already up to the strategic level and becomes the key to success. Therefore, under the competitive environment, achieving competitive advantage is considered as the ability for a company to stay ahead of present or potential competition (Porter, 1985). The theory of competitive advantage is mainly used to answer the question why some companies can have better performance than others (Ibid). Scholars in strategic management have made great progress in answering this question. For example, Prahalad and Hamel (1990) claimed that core competence is the main source that leads to different performances between competitors within an industry. Though, a significant number of results are now available, most of the scholars have different understanding or interpretation about the source of competitive advantage which leads different strategy theories.

3.6 Competitive advantage
Competitive advantage is the means by which firms achieve success. As such, it is not within the domain of any single academic discipline. However, a review of approaches for building competitive advantage illustrates that marketing plays a central role. A number of popular approaches include: strong market positions with products and services not easily substituted, entry barriers, strong bargaining position, mobility barriers; balanced portfolios; core competencies, innovation and speed or time based competition (Eccles and Nohria, 1992). The predominant emphasis is on enhancing, balancing and protecting market positions. As such, competitive advantage is a primary concern for the marketing function within organizations.
In addressing competitive advantage, marketing has drawn extensively on the work of Michael Porter. Porter's "five forces model" (Porter, 1985) provides the basis for structural analysis of industries in most texts (Baker, 1992; Bradley, 1995). Porter's model has also popularized what had tended to be the domain of macro-economists, namely the study of competitiveness. It suggests that study of firm advantage needs to take place in the context of a national environment. The national environment is conceptualized as four determinants (and two exogenous variables) labelled the "diamond". The model advocates that any study of competitive advantage at firm level must take place within the context a particular domestic competitive environment or diamond. Thus, increasingly, marketing courses and texts incorporate the diamond as part of the analysis of industry (Baker, 1992).

Porter (1980) states three main strategies for achieving competitive advantage: Overall cost leadership, differentiation and focus. Grant (2008) state that competitive advantage can be achieved by two types of changes, external and internal changes. The external source refers to customers and consumers behaviors and internal references that change directly are developed by firm’s potential innovations to be superior in comparison with other competitors. Grant (2008) believed that sustainability of strategies based on firm resources are far greater than previous strategies focus on market. There is a distinction between competitive advantage and industry attractiveness for generating the uniqueness and abilities (ibid).

Also producing with lowest standard factors doesn’t reach competitive advantage in developed countries. Companies should be able to re-innovate structures and products to sustain competitive advantage (Porter 2006).

3.7 Porters five force analysis

Porter's Five Forces Analysis is an important tool for assessing the potential for profitability in an industry. With a little adaptation, it is also useful as a way of assessing the balance of power in more general situations. This tool was created by Harvard Business School professor, Michael Porter, to analyze the attractiveness and likely-profitability of an industry. Since publication, it has become one of the most important business strategy tools. The classic article which introduces it is "How Competitive Forces Shape Strategy" in Harvard Business Review 57, March - April 1979, pages 86-93. It draws upon industrial organisation (IO) economics to derive five forces that determine the competitive intensity and therefore attractiveness of a market. Attractiveness in this context refers to the overall industry
profitability. An "unattractive" industry is one in which the combination of these five forces acts to drive down overall profitability. A very unattractive industry would be one approaching "pure competition", in which available profits for all firms are driven to normal profit. In addressing competitive advantage, marketing has drawn extensively on the work of Michael Porter. Porter's "five forces model" (Porter, 1985) provides the basis for structural analysis of industries in most texts (Baker, 1992; Bradley, 1995).

The Porter's 5 Forces tool is a simple but powerful tool for understanding where power lies in a business situation. This is useful, because it helps you understand both the strength of your current competitive position, and the strength of a position you're considering moving into. With a clear understanding of where power lies, you can take fair advantage of a situation of strength, improve a situation of weakness, and avoid taking wrong steps.

Several structural elements within the business environment affect the level of competition in an industry. To these ends, there is continuing interest by academics and practitioners to study the totality of environmental influences or conditioning that are outside an organization's boundary (Smith et al. 1980), and various models have been proposed and discussed (e.g. Henderson 1976; Smith et al. 1980) that examine the external environmental forces that impact on organizations. However, up to now the most significant and dominant paradigm in the literature of industry analysis is Porter’s (1980) competitive forces model. This framework proposes five potential forces of industry competition that have changed the way that managers, consultants and practitioners view the competitive environment (Slater & Olson 2002) and determine the profitability and the degree of attractiveness of a given industry, as has been reported by Blair and Buesseler (1998) for the medical group industry and by Thurlby (1998) for the electricity supply industry.

Porter developed his Five Forces analysis in reaction to the then-popular SWOT analysis which he found unrigorous and ad hoc. (Porter 2002) Porter's five forces is based on the Structure-Conduct-Performance paradigm in industrial organizational economics. It has been applied to a diverse range of problems, from helping businesses become more profitable to helping governments stabilize industries. (Simkovic, 2002) Porter’s five competitive forces that constitute strong threats to a company’s profitability and when act favorably can establish the long run profitability of a given
industry are (Hill & Jones 1995, 70-81; Porter 1980): Porter's study continues a tradition that
dissents from neo-classical economics with its emphasis on the self-adjusting nature of
markets. Porter's theory of competitive advantage is one of a number of theories that place
depend industrialization and innovation at the centre of the process of development and
competition. An extensive review of Porter's (1990) model is contained in O'Connell et al.
(1997). Porter's explanation focuses on particular industries within the nation. Certain
characteristics of the home nation give rise to competitive advantage and geographic
concentration and rivalry enhance this process. There is considerable support, for the
proposition that successful industries usually are part of competitive clusters, arising from
research in a range of different countries reported by Porter (1990).
Further studies undertaken by research teams in other countries; include Cartwright (1993);
Rugman and Verbeke (1993) and Beije and Nuys (1995). These broadly support the findings
on the importance of clusters for competitive advantage, albeit with varying degrees of
agreement on some points and both additions to and qualification of others. In addition,
complementary work on linkages and networks carried out by other theorists, for example
within the industrial district and network paradigms, have clear parallels with Porter's concept
of the cluster. Furthermore, work on new trade theories and economic geography also show
clear similarities with these ideas (cf. Martin and Sunley's (1996) analysis of Krugman's
work).
Thus, Porter has unquestionably attempted to create, and has encouraged a research agenda
that is attempting to produce, a robust explanation for the development of competitive
advantage.

The neo-classical theory is very elegant but it is also abstract. It is not easy to apply it to real
industries because of the general terms in which it is couched. This is why Michael Porter's
work on competitive strategy is so important. Porter described, in detail, the factors that
determine the competitiveness (or market efficiency) of actual industries, for example in
terms of factors such as the level of technological innovation, the ease with which firms can
switch suppliers and the lack of regulatory obstacles. Porter’s analysis of the ‘five forces’
determining industry competitiveness allow strategists to identify the root causes of the level
of competitiveness of a given industry, and thus the drivers of its return on capital. In so
doing, the work connected the theory of competitive markets with the reality of business and industry strategy. (Marcus Williamson, Highland Research and Development Institute)

The ‘5 forces’ framework can be used to help to assess the likely returns on livelihood systems and also to design initiatives to increase their returns, not only at the micro- level but at the regional or national level. It should therefore be a key part of the development experts and policy makers’ conceptual and analytical techniques. (Marcus Williamson, Highland Research and Development Institute) The Porter five force model uses the 5 forces that shape industry structure and competitiveness. These forces are: the threat on new entrants, the bargaining power of suppliers, the bargaining power of buyers, the threat of substitutes and competitive rivalry among the existing competitors (Porter 1980). There are various other researches that add to this model other forces, i.e. complementors (Brandenburger & Nalebuff 1996) or policy (Gold et al. 2004).

Definitely, these five major factors determine the intensity of competition in the industry. (Lynch, 2006) The Five-Force model exams how these five actors influence the competitiveness, and what opportunities and threats they will bring to the company. (Johnson et al., 2005) It contributes for the companies to understand their competitive environment, and create their competitive advantages. (Jobber 2004)

Before describing each particular force it is wise to present some attributes of the Porter’s model. When it was developed it significantly advanced the theory on business strategy. Its advantages are (Grundy 2006):

- It simplifies micro-economic theory into just five major influences.
- It shows how competitive rivalry is very much a function of other four forces.
- It helps to predict the long-term rate of return in a particular industry.
- It goes beyond a more simplistic focus on relative market growth rates in determining the industry attractiveness.
- It helps combine input-output analysis of a specific industry with industry boundaries via entry barriers and substitutes.
- It emphasizes the importance of searching for imperfect markets, which offer more national opportunities for superior returns.
- It emphasizes the importance of negotiating power and bargaining arrangements in determining relative market attractiveness.
• It focuses managers on the external environment for more than traditional SWOT analysis.

Furthermore, Johnson et al. (2005) point out before using the Five-Force model, it is necessary to notice that: (1) this model should not be used for the whole organization because of the differentiation between each unit in an organization; (2) none of these competitive forces are exist independently. I.e. The change in one factor will trigger off change in another. (Johnson et al., 2005) Such as the government policy may change the intensity of rivalry.

Even though many researches attempted to improve the model, by rethinking and reinventing it, this research will use the original set of 5 forces, which was developed by Porter and which can be seen in the figure 3.3 below.

**Figure 3.3 Porters five forces**

Three of Porter's five forces refer to competition from external sources. The remainders are internal threats.

Porter referred to these forces as the micro environment, to contrast it with the more general term macro environment. They consist of those forces close to a company that affect its ability to serve its customers and make a profit. A change in any of the forces normally requires a business unit to re-assess the marketplace given the overall change in industry information. The overall industry attractiveness does not imply that every firm in the industry
will return the same profitability. Firms are able to apply their core competencies, business model or network to achieve a profit above the industry average. A clear example of this is the airline industry. As an industry, profitability is low and yet individual companies, by applying unique business models, have been able to make a return in excess of the industry average.

Porter's five forces include - three forces from 'horizontal' competition: threat of substitute products, the threat of established rivals, and the threat of new entrants; and two forces from 'vertical' competition: the bargaining power of suppliers and the bargaining power of customers. This five forces analysis is just one part of the complete Porter strategic models. The other elements are the value chain and the generic strategies.

3.7.1 Rivalry within the Industry:
Competitive rivalry – refers to an intensity of a competition within an industry. It is often described as a jockeying for position in competitive industry. This force describes the intensity of competition between existing players (companies) in an industry. High competitive pressure results in pressure on prices, margins, and hence, on profitability for every single company in the industry.

The rivalry within an industry depends on

• The slowing growth potential tends to lead to a severe competition as firms need to fight for their market share (Bowman, p.76).
• Barriers to exit are related with costs of leaving the industry. This impediment implies how firms can be challenged to exit owing to the high costs (Shin, 2001).
• The product differentiations enable the firms to gain competitive advantage. In industries where the offerings are distinguished, the competition among rivals tends to be weak as customers are not willing to substitute.
• High fixed costs: the firm must produce its product at a high output level in order to lower per unit cost. This implies that a high level of production will urge the firm to compete for market share to increase its sales and this would cause an increase in rivalry.
• Number of competitors
• Rate of industry growth
• Intermittent industry overcapacity
• Exit barriers
• Diversity of competitors
• Informational complexity and asymmetry
• Fixed cost allocation per value added
• Level of advertising expense
• Economies of scale
• Sustainable competitive advantage through improvisation

The threat of industry competitors determines the intensity of competition in the industry. The threat is high when:
• The capabilities of competitors are nearly the same, and there is no market leader in the industry.
• The competitors have similar strategies or the product differentiation is very low, thus the competition will tend to be a price war.
• Exit barrier is very high
• Switching cost is very low for customer
  (Barney, 2007)

3.7.2 Threat of Substitute Products:

Threat of Substitutes refers to a degree, to which products or services of from other industry can satisfy the same needs of the focal industry. A threat from substitutes exists if there are alternative products with lower prices of better performance parameters for the same purpose. They could potentially attract a significant proportion of market volume and hence reduce the potential sales volume for existing players.

This category also relates to complementary products. Substitute products or services are alternative choices to meet the same types of customer needs (Bowman, p.82). This implies that the more complex the needs being fulfilled by the product and the more difficult it is to distinguish differences, the lower the extent of substitution by customers (Charles and Warren 2006).
The existence of close substitute products increases the propensity of customers to switch to alternatives in response to price increases (high elasticity of demand).

- Buyer propensity to substitute
- Relative price performance of substitutes
- Buyer switching costs
- Perceived level of product differentiation

The competition engendered by a Threat of Substitute comes from products outside the industry. The products or service provided by the substitutes are different from the firms’, but still meet the needs of customers. (Barney, 2007) The threat of substitutes is reducing the potential sales volume and profit of the industry, which will take some customers out of this market. The threat of substitutes will be high when:

- Brand loyalty of customers is very high
- Switching cost is very high for the customer when turn to purchase from the substitutes
- The substitutes couldn’t provide a lower price than the firm

3.7.3 Barriers to New Entrants:

Threat of New Entrants refers to the degree to which new competitors can join an industry. Conditions that make it hard to enter and compete in an industry are called entry barriers. Profitable markets that yield high returns will draw firms. This results in many new entrants, which will effectively decrease profitability. Unless the entry of new firms can be blocked by incumbents, the profit rate will fall towards a competitive level (perfect competition). The competition in an industry will be the higher, the easier it is for other companies to enter this industry. In such a situation, new entrants could change major determinants of the market environment (e.g. market shares, prices, customer loyalty) at any time.

There is always a latent pressure for reaction and adjustment for existing players in this industry. The threat of new entries will depend on the extent to which there are barriers to entry. Empirical findings show whether entry barriers are effective in opposing potential entrants depends on resources possessed. However, effective barriers against new comers may be ineffective against existing firms that spread from other industries (Charles and Warren 2006).
The threat of new entrants depends on the entry barrier of the industry. There are some major barriers of entry:

- Economies of scale
- Product differentiation
- Cost advantage independent of scale, such as proprietary technologies
- Contrived deterrence or retaliation from existing players
- Government regulation and policy (Barney, 2007)
- Capital requirements, includes initial investment and fixed cost
- Switching costs for customers
- Assess to distribution channels, whether it is controlled by existing players (Jobber, 2004; Lynch, 2006)
- Brand loyalty of Customer or supplier to the existing players
- Experience (Johnson, 2005)

Easy to Enter if there is:

- Common technology
- Little brand franchise
- Access to distribution channels
- Low scale threshold

Difficult to Enter if there is:

- Patented or proprietary know-how
- Difficulty in brand switching
- Restricted distribution channels
- High scale threshold

3.7.4 Bargaining Power of Buyers:

Bargaining Power of Buyers refers to the ability of buyers to influence, force the prices down by comparison shopping, or by rising quality expectations. The bargaining power of customers determines how much customers can impose pressure on margins and volumes.
According to Keller and Kotler, buyer’s bargaining power increases when they possess information about suppliers and their prices and costs, when the product is significant as its proportion of total costs, when the product is not differentiated, when they are sensitive to the prices they are charged or when they are able to integrate vertically.

This depends on:
Buyer concentration to firm concentration ratio
· Degree of dependency upon existing channels of distribution
· Bargaining leverage, particularly in industries with high fixed costs
· Buyer volume
· Buyer switching costs relative to firm switching costs
· Buyer information availability
· Ability to backward integrate
· Availability of existing substitute products
· Buyer price sensitivity
· Differential advantage (uniqueness) of industry products
· RFM Analysis

The Buyers purchase the firm’s products or services, their power may decrease the margins of production. (Barney, 2007) The threat of buyers will be high when:
• The buyer group is very small, and the seller group is very large. (Jobber, 2004)
• The firm has lots of rivals, and the differentiation of products or service is very low. It means buyers could purchase from alternative companies. (Lynch, 2006)
• The switching cost from one supplier to another is very low. (Johnson et al., 2005)
• The buyers could not get high economic profits from the product. Thus, the buyers will be more sensitive to the price and cost of the products or service, that they would like lowest price with highest quality. (Barney, 2007).

Buyers are strong if:
• Buyers are concentrated - there are a few buyers with significant market share
• Buyers purchase a significant proportion of output - distribution of purchases or if
• the product is standardized
• Buyers possess a credible backward integration threat - can threaten to buy
• producing firm or rival

Buyers are weak if:
• Producers threaten forward integration - producer can take over own
distribution/retailing
• Significant buyer switching costs - products not standardized and buyer cannot
easily switch to another product
• Buyers are fragmented (many, different) - no buyer has any particular influence on
product or price
• Producers supply critical portions of buyers' input - distribution of purchases

3.7.5 Bargaining Power of Suppliers:
Bargaining Power of Suppliers refers to the ability of suppliers to influence cost, availability,
and quality of input materials to firms within the industry. The term 'suppliers' comprises all
sources for inputs that are needed in order to provide goods or services. To produce a product,
a capability of firm access to raw materials is needed. This requirement affects to buyer-
supplier relationships between the industry and the firm that supply the raw materials used in
manufacturing. Thereby, supplier’s bargaining power increases when the purchase is
significant to the buyer, when there are few alternative, when buyers have high switching
costs or when sellers are able to integrate upstream (QuickMBA 1999-2004).

This depends on:
• Supplier switching costs relative to firm switching costs
• Degree of differentiation of inputs
• Presence of substitute inputs
• Supplier concentration to firm concentration ratio
• Employee solidarity (e.g. labor unions)
• Threat of forward integration by suppliers relative to the threat of backward integration by
  firms
• Cost of inputs relative to selling price of the product.

Richard Lynch (2006) argues suppliers are absolutely necessarily for every organization that
supports the organization’s final production by raw materials or services. The suppliers will
be more powerful when:
• The supplier group is very small or there is no substitute for the firms to buy raw materials, thus there are limited opinions for the firm to switch from one supplier to another. (Lynch, 2006)
• The supplier has a wide range customers, thus they are more powerful in the bargaining (Jobber, 2004)
• The payment for supplier takes a large part of total cost. (Lynch, 2006)
• The switching cost from one supplier to another is very high, especially when the production requires some specialist materials of a supplier. (Johnson et al., 2005)
• The entry barrier is very low, hence the suppliers are easily to enter their buyers’ market to gain more margins, and compete directly with the buyers. (Johnson et al., 2005)

Suppliers are strong if:
• Credible forward integration threat by suppliers
• Suppliers concentrated
• Significant cost to switch suppliers

Suppliers are weak if:
• Many competitive suppliers - product is standardized
• Purchase commodity products
• Credible backward integration threat by purchasers
• Concentrated purchasers

Furthermore, as it stated at the beginning of this sector, these five forces will influence each other in the industry. Thus, the threat of rivals will also high when it has a high threat of entrant or high threat of substitutes in an industry. In summary, the five forces model is used to help the firm analyze whether the industry is profitable, what opportunity and threat it will face in the future. After doing the internal analysis, the firms could integrate their strength and weakness with the opportunities and threats, and then deciding which generic strategies should be taken in this industry.
3.8 SWOT

A useful tool to analyze a company is a SWOT analysis. Via a SWOT analysis, we can see the strengths, weaknesses, opportunities and threats that affect the performance of an organization (Daft, 2003, p.248). SWOT analysis was first introduced by Stanford University’s Albert Humphrey in the 1960’s (GRIN Verlag, 2007, p. 2). SWOT analysis is one of the most popular analytic techniques amongst competitive intelligence professionals (Fehringer, 2007, p. 54), as well as many other disciplines involved with strategic planning (Choi, Lovallo, & Tarasova, 2007). SWOT analysis outlines the strategic strengths, weaknesses, opportunities, and threats to determine an organization’s competencies as well as identify future opportunities (Hunger & Wheelen, 2010).

SWOT analysis is a framework links the firm’s capabilities to its relevant competitive environment. I.e. the SWOT analysis focuses on evaluating the strategic position of a firm by analyzing its strengths, weaknesses, opportunities and threats (fig ). (Jobber, 2004) It summarizes the key issues from the business environment and the strategic capability of an organization that are most likely to impact on strategy development. (Johnson et al., 2005, p102)

![SWOT Analysis Diagram](image)

**Figure 3.4 :** SWOT analysis Source: (GRIN Verlag, 2007)
The strengths are those points where a company has a competitive advance in comparison with their competitors. The weaknesses of a company are those points where the company has a competitive disadvantage in comparison with their competitors. In fact, by the analysis of the internal environment of a company, it should be possible to determine the strengths and weaknesses of that company. The SWOT analysis can be seen as a short summary of the internal environment.

The opportunities and threats of a company consist of external influences. Opportunities are characteristics of the external environment that have the potential to help the organization to achieve its strategic goals. Threats are characteristics of the external environment that may prevent the organization from achieving its strategic goals (Daft, 2003, p. 249). External influences are a part the external environment of a company. By using the dissection of the external environment, it is possible to determine the opportunities and threats. The opportunities and threats are also a summary of the external environment.

A SWOT analysis is quite useful because with it, it is possible to see what a firm is and is not able to do in a quick and clarifying way. The competitive strategy of a company should fit with the SWOT analysis of a company. If a company is for example very cost efficient because they have a huge capacity engine compound, they shouldn’t focus on their quality but on their quantity.

**Strengths**

Strengths are the qualities that enable us to accomplish the organization’s mission. These are the basis on which continued success can be made and continued/sustained. Strengths can be either tangible or intangible. These are what you are well-versed in or what you have expertise in, the traits and qualities your employees possess (individually and as a team) and the distinct features that give your organization its consistency. Strengths are the beneficial aspects of the organization or the capabilities of an organization, which includes human competencies, process capabilities, financial resources, products and services, customer goodwill and brand loyalty. Examples of organizational strengths are huge financial resources, broad product line, no debt, committed employees, etc.
**Weaknesses-**

Weaknesses are the qualities that prevent us from accomplishing our mission and achieving our full potential. These weaknesses deteriorate influences on the organizational success and growth. Weaknesses are the factors which do not meet the standards we feel they should meet. Weaknesses in an organization may be depreciating machinery, insufficient research and development facilities, narrow product range, poor decision-making, etc. Weaknesses are controllable. They must be minimized and eliminated. For instance - to overcome obsolete machinery, new machinery can be purchased. Other examples of organizational weaknesses are huge debts, high employee turnover, complex decision making process, narrow product range, large wastage of raw materials, etc.

**Opportunities-**

Opportunities are presented by the environment within which our organization operates. These arise when an organization can take benefit of conditions in its environment to plan and execute strategies that enable it to become more profitable. Organizations can gain competitive advantage by making use of opportunities. Organization should be careful and recognize the opportunities and grasp them whenever they arise. Selecting the targets that will best serve the clients while getting desired results is a difficult task. Opportunities may arise from market, competition, industry/government and technology. Increasing demand for telecommunications accompanied by deregulation is a great opportunity for new firms to enter telecom sector and compete with existing firms for revenue.

**Threats-**

Threats arise when conditions in external environment jeopardize the reliability and profitability of the organization’s business. They compound the vulnerability when they relate to the weaknesses. Threats are uncontrollable. When a threat comes, the stability and survival can be at stake. Examples of threats are - unrest among employees; ever changing technology; increasing competition leading to excess capacity, price wars and reducing industry profits; etc. SWOT analysis is one of the most popular analytic techniques amongst competitive intelligence professionals (Fehringer, 2007, p. 54), as well as many other disciplines involved with strategic planning (Choi, Lovallo, & Tarasova, 2007). SWOT analysis outlines the strategic strengths, weaknesses, opportunities, and threats to determine an organization’s competencies as well as identify future opportunities (Hunger & Wheelen, 2010).
SWOT analysis is used by an organization to define the situation they are currently in, or likely to be in within the near future. As a type of situational analysis, SWOT is the acronym for the analytic technique that assesses the Strengths, Weaknesses, Opportunities, and Threats of a situation. The “basic assumption of a SWOT analysis is that a company must align internal activities (Strengths and Weaknesses) with external realities (Opportunities and Threats)” to successfully produce results that can help create strategy (GRIN Verlag, 2007, p. 4) SWOT is an acronym for Strengths, Weaknesses, Opportunities and Threats. By definition, Strengths (S) and Weaknesses (W) are considered to be internal factors over which you have some measure of control. Also, by definition, Opportunities (O) and Threats (T) are considered to be external factors over which you have essentially no control.

SWOT analysis is a framework links the firm’s capabilities to its relevant competitive environment. I.e. the SWOT analysis focuses on evaluating the strategic position of a firm by analyzing its strengths, weaknesses, opportunities and threats (fig ). (Jobber, 2004) It summarizes the key issues from the business environment and the strategic capability of an organization that are most likely to impact on strategy development. (Johnson et al., 2005, p102)

All these parameters have an impact on the outcome of implementation of a certain strategy and its goal. In our case the internal environment is regarded as the marketing information system and the external environment the company, departments and stakeholders. By relating the strengths and weaknesses of a marketing information system with the opportunities and possible threats in the environment where its supposed to be implemented, we can weigh/consider their impact and form a strategy by using the internal strengths together with the external opportunities to reinforce the base of the strategy and try to eliminate/reduce weaknesses and threats (Grant 2005).

Internal analysis (Strengths and Weaknesses): The internal analysis should lead to an assessment of internal strengths/weaknesses that could be of competitive advantage/disadvantage. In this case the intrinsic advantages and disadvantages of marketing information tool.

External analysis (Opportunity and Threats): The external analysis focuses on environmental characteristics that could produce opportunities as well as threats relative to competitive solutions.
Strengths and weaknesses are based on internal information from the organization; primarily acquired through employee surveys and feedback (Olsen, 2008). Opportunities and threats are gathered from external information, primarily acquired through secondary sources (Olsen, 2008). Secondary sources include looking at industry data, consumer surveys, competitors, environmental (of the market) data, and evaluating what resources, capabilities, assets, or processes the organization has or does not have. Including Internal and External levels of analysis and information is critical to move SWOT’s findings into strategy; this is also reflected in a supplemental model depicted in Harvard Business Essentials (Figure 3.5)

![SWOT Matrix With Internal and External Division and Strategy Steps](image-url)

**Figure 3.5**: SWOT Matrix With Internal and External Division and Strategy Steps (Harvard Business Essentials, 2005, p. 3)

After completing the SWOT analysis, the firm should decide how to turn weaknesses into strengths and threats into opportunities (Jobber, 2004, p44), or how to deal with the threats and capitalize on the opportunities through its strengths and weaknesses (Johnson et al., 2005, p102).

SWOT analysis is not always the best technique to utilize in strategic planning; however, it is a versatile technique that can easily be utilized in conjunction with other analytic techniques.
In order to know when it is the best time to utilize SWOT, it is important to understand the general strengths and weaknesses of the technique. Per Mercyhurst College’s research in its 2009 graduate level Advanced Analytic Techniques course, the class “evaluated [SWOT] based on its overall validity, simplicity, flexibility and its ability to effectively use unstructured data.” The strengths and weaknesses highlighted can be seen in Figure 3.6

![Figure 3.6: Strengths and Weaknesses of SWOT (Mercyhurst, 2009)](image)

The primary strength of SWOT analysis (as well as the reason for its popularity) is its simplicity. SWOT “is a useful construct to help show where your company stands versus a competitor. It is [widely] well-known and accepted, relatively straightforward, and understandable;” all of these qualities make it useful to people throughout many levels of an organization (Fehringer, 2007, p. 56).

Pairing with Other Analytic Techniques or Left Standing Alone? An important area to examine concerning SWOT analysis is the use of the technique with other types of analysis. As will be discussed, some scholars and practitioners argue that SWOT should be utilized in conjunction with other analytic techniques, and some argue that it should be used by itself. Either way, there has not been an accepted standard in this area. SWOT does have the potential to provide strategic insight on its own when utilized correctly. When “matching the internal factors with external factors, SWOT analysis yields a list of action items as the basis for strategies (Koo & Koo, 2007). However, this is highly dependent on the type of preliminary research conducted before the SWOT analysis begins, the perspectives of those conducting the analysis, and the specificity put into the analysis.
Often times, scholars and practitioners note that SWOT should be paired with other techniques, but due to such variance of SWOT’s use, rarely are there specific techniques suggested to work best with SWOT. Without specific detail, nor further explanation, Janice Donaldson explains that “by paying attention to external Political, Economic, Socio-cultural, and Technological (PEST analysis) factors, entrepreneurs can development a game plan using their company’s SWOT (2008). A similar suggestion, made by E. K. Valentin, is that Porter’s Five Forces Analytical model sufficiently complements SWOT analysis (2001, p. 55)

Figure 3.7: PEST Analysis (left ) and Porter’s Five Forces(right) and Competitor profiling(PESTLE) source (Maxi-pedia,2010)

PEST, Porter’s Five Forces, and SWOT all utilize basic frameworks for reviewing a situation (Chapman, 2005). Another use for SWOT is in the preliminary stages of a balanced scorecard. “It is believed that by first implementing a SWOT analysis, to develop a set of strategies that make sense, will serve as a stepping stone toward the actual implementation of a balance scorecard” (Lee, Leung, Lo & Ko, 2000, p. 411). Whether it is suggested that one of these analytic techniques is performed previous to another is something that has not been accurately studied in terms of effectiveness. It does seem logical that by simply utilizing multiple techniques, regardless of order, more specific, actionable information should result. This idea is referred to as triangulation. Triangulation is a metaphor from navigation and military strategy that uses multiple reference points to locate an object’s exact position (Jick, 1979, p. 602). In terms of analytic use, triangulation uses multiple methodologies (from differing perspectives, and often times varying in qualitative or quantitative focus) to study the same issue (Jick, 1979, p. 602). Utilizing a situational analysis, like SWOT, with two other forms of analysis is likely to create a much more accurate, well-balanced final analytic product, often times in the form of strategic insight.
3.9 Internationalization

Historically, discussion on Internationalization can be traced to economic commentators such as Adam Smith (Sutherland, 1993) and David Ricardo (Sraffa, 1951). Smith remarked on the importance of recognizing the scarcity of resources and subsequently endeavoring to implement a distribution system which involved: transporting either the rude or manufactured product from the places they abounded to where they are wanted (Sutherland, 1993). Internationalization is one of the biggest challenges for the high-tech S.M.E. which is already very limited in its resources. Although the Internationalization process of companies has been the subject of widespread research since the 1960s, the concept “Internationalization” is rarely explicitly defined. (Korhonen,1996). Internationalization is considered to be the process through which a firm moves from operating solely in its domestic marketplace to international markets (Andersen, 1993; Buckley and Casson, 1998; O’Farrell et al., 1998). Internationalization can be defined as "the process of increasing involvement in international operations"(Luostarinen R. & Welch L. 1990). The process of internationalization means all the efforts and modes a company uses to enter into foreign markets. Internationalization, commonly understood to be the process of adapting firms’ operations to international environments (Calof and Beamish, 1995), is thus an issue of importance for firms, and often results in useful learning outcomes for firms (Zahra, Ireland and Hitt, 2000) and has a significant impact on their performance (Lu and Beamish, 2001).

3.9.1 Theories of Internationalization

There are a number of theories related to Internationalization. The conceptual theories, which are the most well known in the literature, are the Chain of Establishment (Johanson & Vahlne, 1977), the Internalization Theory (Buckley & Casson, 1976; Rugman, 1980), the Eclectic theory (Dunning, 1980), the Transaction Cost theory (Anderson & Gatignon, 1986) and the Organizational Capability Perspective (Aulakh & Kotabe, 1997; Madhok, 1997). The above conceptual frameworks provide groups of factors, which affect the entry strategy selection decision. However, all frameworks are based on judgment and none of them provides a quantitative methodology that provides management with the tools, which assist them to
select the most appropriate expansion strategy. (Yannis, Georgiou & Porgianos, 1999). The following section briefly describes some important internationalization theories.

### 3.9.2 Resource Allocation Theory

The Resource Allocation (RA) theory of competition (Hunt 2000) is based on the premise that (1) firm resources are heterogeneous and imperfectly mobile and (2) intra industry demand is substantially heterogeneous, thereby resulting in diversity in firms’ sizes, scopes, and levels of profitability. A firm’s resources are financial, physical, legal, human, organizational, informational, and relational. Because firm resources are heterogeneous and relatively immobile, some firms have a comparative advantage which then results in competitive advantage and superior financial performance.

When applied in a global market, the RA theory builds on the international trade theory of comparative advantage and is analogous to the organizational capability theory (Cantwell 1995; Prahalad and Hamel 1988). A firm enters global markets when it can exploit and develop its comparative advantage, capabilities, and societal resources for a sustainable competitive advantage (Andersen 1997). However, the specific mode of foreign market entry depends on the type of resource advantage. For example, if the firm-specific advantage is superior knowledge based on tacit information; the firm should pursue a hierarchical governance structure (internalization) rather than a market structure. In contrast, if the firm faces capability constraint in an unfamiliar area of activity, collaborations are a useful vehicle for enhancing knowledge (Madhok 1997). Similarly, a strategic alliance between two firms becomes a resource when the relationship promotes efficiency and effectiveness in a market offering.

### 3.9.3 Transaction cost analysis theory (TCA)

Transaction Cost Analysis (TCA) theory has been developed primarily by Oliver Williamson but other researchers have proposed additional considerations as they have attempted to operationalize and test TCA (Rindfleisch and Heide 1997). Transaction costs arise from the problem of coordinating the activities performed by different people, groups, departments or firms. They include the costs of finding transaction partners, negotiating agreements, and monitoring and controlling the activities of the transaction partner. They include the direct coordination costs involved in managing a relationship as well as potential opportunity costs.
TCA identifies three fundamental characteristics of transactions that affect the nature and extent of the coordination task facing the parties involved and indicates under what conditions different methods of coordination or governance modes are more efficient in handling the coordinating activities involved and hence minimize transaction costs. Three key dimensions of transactions have been identified by Williamson (1975, 1985) as affecting the nature and extent of the coordination task: (a) the degree to which durable transaction specific investments are involved, i.e. asset specificity; (b) the frequency with which transactions recur; and (c) the level of uncertainty.

The TCA theory belongs to the new institutional economics paradigm, in which the firm is viewed as a governance structure (Williamson 1985). According to TCA theory; the costs of conducting economic exchange in a market may exceed the costs of organizing the exchange in the firm. Transaction costs are the costs of running the system and include ex ante-costs, such as drafting and negotiating contracts, and ex post costs, such as monitoring and enforcing agreements. The assumptions of TCA theory (bounded rationality and opportunism) provide the motivation for firms to economize on transactions by choosing the appropriate governance structure. Thus, when adoption costs (against environmental uncertainty), performance costs (against behavioral uncertainty), and safeguarding costs (against asset specificity and opportunistic behavior) are absent or low, firms favor market governance. If these costs are high enough that they exceed the production cost advantages in the market, firms favor internal organization.

In the last decade, TCA has been commonly applied in research on foreign market entry modes (e.g. Erramilli and Rao 1993). In choosing entry modes, firms make trade-offs between control (benefit of integration). More recently, research has focused on non transaction cost benefits that flow from increased control, such as coordination of strategies and extension of market power (Erramilli and Rao 1993; Hill, Hwang, and Kim 1990). TCA theory focused on costs and how these costs are affecting a firm’s choice of market and mode of entry.
3.9.4 Bargaining power theory

Bargaining Power (BP) theory asserts that the entry mode a firm chooses depends on the relative bargaining power of the firm and the foreign government (Franko, 1971; Stopford and Wells, 1972; Tallman and Shenkar, 1994). As noted by Gomes-Casseres (1990) and others who have employed the bargaining power framework, access to foreign markets is controlled by political actors at home and abroad, so that the initial market entry decision has to include the political imperative. Without these actors’ explicit or implicit permission, no subsequent marketing activity is possible (Boddewyn and Brewer, 1994). International firms must often negotiate with a variety of government actors to accomplish all or part of their objectives (Wells, 1973). Thus, the bargaining power of the political and corporate actors in market entry decisions becomes a salient consideration (Fagre and Wells, 1982; Gomes-Casseres, 1990).

The term bargaining power refers to a bargainer’s ability to set the parameters of the discussion, win accommodations from the other party, and skew the outcome of the negotiation to the desired ownership alternative (Lax and Sebenius, 1986; Tung, 1988). A primary source of the host government’s power in the negotiations is its ability to control market access (Kumar and Subramanian, 1997) and to hand out or withdraw incentives for the investment project. On the other hand, as noted by Kumar and Subramanian (1997), BP theory suggests that much of the firm’s bargaining power stems from “ownership advantages” that it possesses, such as the ability to employ people and contribute to the local economy. According to the bargaining power theory, the actual mode of entry a firm eventually settles for will depend on the relative bargaining power between the firm and the host government.

3.9.5 Dunning’s Eclectic theory

The eclectic theory provides a multi-theoretical approach for studying the choice of entry mode: international trade theory, resource-based theory and transaction cost theory are the basic theories used. It is an overall organizing paradigm for identifying the variables from each approach that are most relevant in explaining a wide range of different environments affecting the entry mode choices of the investing firms. The eclectic theory claims that the choice of the wholly owned subsidiary mode occurs when all three types of advantages are beneficial. If one of the three legs falls short the firm should then consider a non-internal mode of entry. The eclectic theory permits researchers to create determinants in order to
predict entry mode. The eclectic paradigm developed by Dunning (1980, 1988, 1993) integrates several strands of international business theories on cross-border activities. It proposes that three types of advantages/variables influence cross-border business activities: ownership-specific variables, location-specific variables and internalization variables.

Dunning (1977, 1980, 1988) proposed a comprehensive framework, which stipulated that the choice of an entry mode for a target market is influenced by three types of determinant factors: ownership advantages of a firm, location advantages of a market, and internalisation advantages of integrating transactions within the firm. Dunning's eclectic, or OLI, theory as applied to entry-mode selection states that firms will choose the most appropriate form of entry into a new international market by considering their ownership advantages, the location advantages of the country under consideration, and the internalization advantages of the particular situation.

A brief description of the main effects of these factors is presented below:

**Ownership Advantages (O):**
According to Porter (Porter, 1980) Ownership advantages are firm-specific competitive advantages that the firm may possess. These are demonstrated by the firm's international experience, size, their ability to differentiate their product or service, the adaptability of the product or service, the service intensity and the technology intensity of their offerings (Dunning, 1993). Ownership advantages need to be both unique and sustainable in order to provide the firm with a competitive advantage in entry-mode selection (Porter, 1980).

Ownership advantage specific variables can be divided into asset specific advantages and transaction variables. Ownership asset specific variables include various tangible and intangible assets owned by the investing firm whereas transaction specific advantage includes variables related to the ability of firms to capture the transactional benefits from the common governance of multiple and geographically dispersed activities.

To compete with host country firms in their own markets, firms must possess superior assets and skill that can earn economic rents that are high enough to counter the high costs of servicing these markets (Agarwal & Ramaswami, 1992). Ownership variables are unique internal factors that generate the firm’s competitive advantage in the marketplace. A number of these ownership specific variables are expected to have an impact on a firm’s choice of ownership structure.
To compete with host country firms in their own markets, firms must possess superior assets and skills which are reflected by its size and multinational experience, and skills by its ability to develop differentiated products or services which cannot easily be duplicated by competitors. When a firm possesses the ability to develop differentiated products, it may run the risk of loss of long-term revenues if it shares this knowledge with host country firms. Therefore, when the firm possesses these skills, higher control modes may be more efficient. There is substantial empirical support for the use of higher control modes with higher levels of product differentiation (Anderson and Coughlan 1987; Caves 1982; Coughlan 1985; Coughlan and Flaherty 1983; Davidson 1982; Stopford and Wells 1972).

Firms need asset power to engage in international expansion and to successfully compete with host country firms. The possession of financial and experiential resources provide a method for entry into otherwise closed markets. Resources are needed for absorbing the high costs of marketing, for enforcing patents and contracts, and for achieving economies of scale (Hood and Young 1979). The size of the firm reflects its capability for absorption of these costs (Buckley and Casson 1976; Kumar 1984). Empirical evidence indicates that the impact of firm size on foreign direct investment is positive (Buckley and Casson 1976; Cho 1985; Caves and Mehra 1986; Yu and Ito 1988; Terpstra and Yu 1988; Kimura 1989).

Firms without foreign market experience are likely to have greater problems in managing foreign operations. They have been observed to overstate the potential risks, while understating the potential returns of operating in a foreign market. This makes choice of non-investment modes more probable for these firms (Caves and Mehra 1986; Gatignon and Anderson 1988; Terpstra and Yu 1988). Conversely, firms with higher multinational experience may be expected to prefer investment modes of entry.

**Location Advantages (L):**

Location-specific advantages (L) are essential in determining where firms will engage in cross-border value-adding activities. The level of location specific advantages may also be expected to influence the ownership strategies chosen. Location advantages are country-specific factors related to the market under consideration -- market potential and market risk (Root, 1987) -- and are available to all firms in that particular
market (Dunning, 1988). However, some firms are better able to utilize these location advantages than other firms, thus enhancing their competitive advantage either within the new market, for example through better coordination of within-country activities, or internationally, for example providing lower cost labour which would result in a cost advantage in all markets where the firm's products are sold (Dunning, 1988). Factors indicating location advantages can include sales demand and potential demand i.e. market potential, differences or similarity in culture, economic, legal, political and trade policies i.e. investment risk, similarity of market infrastructures and the availability of lower production costs (Dunning, 1993).

Firms interested in servicing foreign markets are expected to use a selective strategy and favour entry into more attractive markets. This is because their chances of obtaining higher returns are better in such markets. Market potential (size and growth) has been found to be an important determinant of overseas investment (Forsyth 1972; Weinstein 1977; Khoury 1979; Choi, Tschoegl and Yu 1986; Terpstra and Yu 1988). In high market potential countries, investment modes are expected to provide greater long-term profitability to a firm, compared to non-investment modes, through the opportunity to achieve economies of scale and consequently lower marginal cost of production (Sabi 1988).

Changes in government policies may cause problems related to repatriation of earnings, and in extreme cases, expropriation of assets (Root 1987). Researchers have suggested that the restrictive policies of a host country's government are likely to impede inward foreign investments (Rugman 1979; Stopford and Wells 1972). In these countries, a firm would be better off not entering; but if it does, it may favour use of non-investment options.

**Internalization Advantage (Contractual Risk) (I)**

The last strand of the eclectic approach comprises Internationalization advantages (I) that the company has in transferring assets within their organizations instead of via the market, because of the market failures. The internalization (I) variables are concerned with the cost of choosing a hierarchical mode of operation over an external mode (Dunning, 1988, 1993). The internalizing of international operations comes at a cost. These costs must be compared with
the costs of finding and maintaining an external relationship to perform the same functions in
the international markets.

The greater the perceived costs of transactional market failure – and the greater the benefits of
circumventing market failure – the more likely the company will exploit its ownership-
specific advantage within the firm and the greater the degree of ownership they will prefer.
Internalization (I) advantages are concerned with the costs of choosing a hierarchical mode of
operation over an external mode (Dunning, 1993, 1988). The internalizing of international
operations comes at a cost which Williamson (1981) refers to as transaction costs. These
transaction costs must be included in consideration of entry-modes (Contractor, 1990;
Hennart, 1989; Gatignon and Anderson, 1988), they unfortunately cannot be accurately
calculated before the international operation has been established (Dunning, 1993; Buckley,
1988). Erramilli and Rat (1993) and Gatignon and Anderson (1988) have attempted to
measure transaction costs ex ante through the use of management perceptions. However, as
pointed out in the transaction cost literature, actual transaction costs cannot be properly
judged ex ante but are affected by the actions of the parties involved after the international
operation has been established (Dunning, 1993). For example, while cooperative ventures are
formed with the expectation that all parties will contribute the agreed-upon resources, after
formation cooperative venture partners may experience shirking or management conflicts.
These tactics may adversely affect the venture's operation and create additional transaction
costs not anticipated prior to venture formation (Gomes-Casseres, 1989).

Dunning (1993) has suggested that the motivation for foreign market expansion may
influence the entry-mode selection process, despite perceptions of the OLI advantages.
Motivations can include market-seeking, resource-seeking, technology-seeking, cost-
reduction seeking, and client following activities. Some preliminary evidence on the influence
of motivational factors can be found in a few previous entry-mode studies (Brouthers 1996;

In relation to market entry, the eclectic paradigm suggests that firms make a choice based on
an evaluation of the costs of an entry mode relative to its objectives. Johanson and Vahlne
(1990) suggest that the eclectic paradigm has high explanatory power for firms having
experience from many regions of the world.
3.10 International Market Entry Strategy:
An international market entry strategy consists of decisions concerning the position of the firm in the chosen international market, the market entry modes and scheduling of international expansion. (Hans et al, 1999) International market entry strategy is a comprehensive plan which sets forth the objectives, goals, resources, and policies that will guide a company’s international business operations over a future period long enough to achieve sustainable growth in world markets. For most companies the entry strategy’s time horizon is from three to five years.

As per Root (1994), constituent product/market entry strategies require decisions on (1) the choice of a target product/market, (2) the objectives and goals in the target market, (3) the choice of an entry mode to penetrate the target country, (4) the marketing plan to penetrate the target market, and (5) the control system to monitor performance in the target market.

3.10.1 International Market Entry Mode:
Entry mode is defined as the process of establishing the set of procedures through which the firm transfers its products, resources and activities to a foreign market (Root, 1994). Foreign market entry mode can also be defined as institutional arrangements that allow firms to use their product or service in a country exchange (Calof, 1993). The term market entry mode includes not only management decisions of market entry but also the different possibilities and forms of expression (cf. Ranner, 1993).

The entry mode chosen has a major impact on the level of control the company has over the venture (Root, 1994). As entry modes have a major impact on the firm’s overseas business performance, their choice is regarded as a critical international business decision (wind and Perlmutter 1977; Anderson and Gatignon 1986; Root 1987; Terpstra 1987; Hill et al. 1990). There is considerable disagreement over which mode tends to yield a higher profitability (Woodcock, Beamish and Makino, 1994).
3.10.2 Types of International Market Entry Modes:

According to Darling and Kash “Firms can plan entry in one of two ways from an economic perspective. It can export products to market from a production base in the home country or another country or it can transfer resources such as technology, capital, human skills and enterprise to the foreign market.” (European Business Review, 1998).

Johansson (1999) states that there are four modes of entry into foreign markets: exporting, licensing, strategic alliance and wholly owned subsidiary. These modes and their break-up is shown in table 3.1

<table>
<thead>
<tr>
<th>Exporting</th>
<th>Strategic alliance</th>
<th>Wholly owned subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect exporting via piggybacking, consortia, export management companies, trading companies, broker</td>
<td>Distribution alliance</td>
<td>Assembly</td>
</tr>
<tr>
<td>Direct exporting, using market country agent or distributor</td>
<td>Manufacturing alliance</td>
<td>Full-fledged manufacturing</td>
</tr>
<tr>
<td>Direct exporting, using own sales subsidiary, Direct marketing, including mail order, telemarketing</td>
<td>R &amp; D alliance</td>
<td>Research and development</td>
</tr>
<tr>
<td>Licensing</td>
<td>Joint venture</td>
<td>Acquisition</td>
</tr>
<tr>
<td>Technical licensing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contract manufacture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Original Equipment Manufacturing(OEM)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnkey contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Franchising</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3.1: Types of International Market Entry Modes: (source Root, 1994)

Thus there are numerous options of international market entry mode to a firm wanting to enter the foreign markets. This section has also described the various alternative international market entry strategies available. These are summarised in the figure 3.8 given below.
Each of the international entry mode has got its sets of advantages and disadvantages. These can be summed up as given in the table 3.2 below.
<table>
<thead>
<tr>
<th><strong>Entry Mode</strong></th>
<th><strong>Advantages</strong></th>
<th><strong>Disadvantages</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect exporting</td>
<td>• Low commitment (in terms of resources) • Low risk</td>
<td>• Lack of control • Lack of contact with foreign market • No learning experience • Potential opportunity cost</td>
</tr>
<tr>
<td>Direct exporting</td>
<td>• More control (compared to indirect exporting) • More sales push</td>
<td>• Need to build up export organization • More demanding on resources</td>
</tr>
<tr>
<td>Licensing</td>
<td>• Little or no investment • Rapid way to gain entry • Managerial motivation • Low Financial risk • Relatively low development costs</td>
<td>• Lack of control • Potential opportunity cost • Need for quality control • Risk of creating competitor • Limits market development</td>
</tr>
<tr>
<td>Franchising</td>
<td>• Little or no investment • Rapid way to gain entry • Managerial motivation • Low Financial risk • Relatively low development costs</td>
<td>• Need for quality control • Lack of control • Risk of creating competitor • Sharing of profit “pie” • Possible loss of Know-how to potential competitor</td>
</tr>
<tr>
<td>Contract manufacturing</td>
<td>• Little or no investment • Overcome import barriers • Cost savings</td>
<td>• Need for quality control • Risk of bad press (e.g, child labour) • Diversion to grey and/or black markets</td>
</tr>
<tr>
<td>Joint venture</td>
<td>• Risk sharing • Less demanding on resources (compared to wholly-owned) • Potential of synergies (e.g, access to local distribution network)</td>
<td>• Risk of conflicts with partner(s) • Lack of control • Risk of creating competitor</td>
</tr>
<tr>
<td>International Strategic Alliances</td>
<td>• Similar to International joint ventures</td>
<td>• May be more difficult to manage than International joint ventures</td>
</tr>
<tr>
<td>Acquisition</td>
<td>• Full control • Access to local assets (e.g, plants, distribution network, brand assets) • Less competition</td>
<td>• Costly • High risk • Need to integrate differing national/corporate cultures • Cultural clashes</td>
</tr>
<tr>
<td>Wholly owned subsidiary / Greenfield</td>
<td>• Full control • Latest technologies • No risk of cultural conflicts • Enables Global Strategic Coordination • Protects technology</td>
<td>• Costly • Time consuming • High political and financial risks • Requires overseas management skills</td>
</tr>
</tbody>
</table>

Table 3.2: Advantages and Disadvantages of different modes of entry (Root, 1994)
3.10.3 Choice of entry mode

Entry modes may be differentiated according to three characteristics of the modes that have been identified in previous research (Maignan and Lukas, 1997; Woodcock et al., 1994):

- quantity of resource commitment required;
- amount of control;
- level of technology risk.

Normative decision theory suggests that the choice of a foreign market entry mode should be based on trade-offs between risks and returns. A firm is expected to choose the entry mode that offers the highest risk-adjusted return on investment. However, behavioural evidence indicates that a firm's choices may also be determined by resource availability and need for control (Cespedes 1988; Stopford and Wells 1972).

Resource commitments are the dedicated assets that cannot be employed for other uses without incurring costs. Resources may be intangible, such as managerial skills, or tangible, such as machines and money. Resource availability refers to the financial and managerial capacity of a firm for serving a particular foreign market.

Control is the ability and willingness of a firm to influence decisions, systems, and methods in foreign markets. Control refers to level of authority a firm may exercise over systems, methods, and decisions of the foreign affiliate. Entry mode literature focuses on control because it is the most important determinant of risk and return (Anderson and Gatignon, 1986). Each entry mode falls into one of two levels of control:

1. high- or full-control modes (sole ownership); or
2. low- or shared-control modes (collaborative modes of operation).

Generally, a full-control mode requires the highest commitment of company resources, exposes the company to the highest level of business risk, and allows the highest return on investment; while a shared-control mode requires low-to-moderate commitment of resources, exposes the company to low-to-moderate business risk, and allows the company low-to-moderate return on investment (Anderson and Gatignon, 1986; Douglas and Craig, 1995). Hence, there is a mapping from an entry mode to the level of control the entry mode allows, with sole ownership usually affording the investor maximum control of the foreign affiliate.
and highest return on investment, but subjects the investor to maximum risk exposure (Anderson and Gatignon, 1986). This mapping is general and exceptions can be found. It is possible for a firm to exercise control out of proportion to the firm’s equity share in the business venture for some other reason.

In general, when a firm moves from licensing/franchising to joint venture to wholly-owned subsidiary (WOS), the firm’s investment and the degree of control that the firm has over the operations increase (Agarwal and Ramaswami, 1992; Hennart, 1989; Root, 1994).

Root has devised a framework for selecting international market entry mode based on the factors of control, risk, resources and dissemination. This is shown in the figure 3.9 below.

### Entry Mode Decision Framework

<table>
<thead>
<tr>
<th>Licensing</th>
<th>Exporting</th>
<th>Intermediaries</th>
<th>Direct</th>
<th>Joint Venture</th>
<th>Wholly-owned Subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control</td>
<td>Control</td>
<td>Resources</td>
<td>Risk</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
<td></td>
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</tr>
<tr>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
<td></td>
</tr>
</tbody>
</table>

Source: Root 1994

**Figure 3.9:** Entry Mode Decision Framework

One approach for the strategy decision rule is to choose that entry mode that maximizes the profit contribution over the strategic planning period within the constraints imposed by (1) the availability of company resources, (2) risk, and (3) nonprofit objectives.
Entry mode literature focuses on control because it is the most important determinant of risk and return. Each entry mode falls into one of two levels of control: (1) high- or full-control modes (sole ownership); or (2) low- or shared-control modes (collaborative modes of operation). Generally, a full-control mode requires the highest commitment of company resources, exposes the company to the highest level of business risk, and allows the highest return on investment; while a shared-control mode requires low-to-moderate commitment of resources, exposes the company to low-to-moderate business risk, and allows the company low-to-moderate return on investment. Hence, there is a mapping from an entry mode to the level of control the entry mode allows, with sole ownership usually affording the investor maximum control of the foreign affiliate and highest return on investment, but subjects the investor to maximum risk exposure. In general, when a firm moves from licensing/franchising to joint venture to wholly-owned subsidiary (WOS), the firm’s investment and the degree of control that the firm has over the operations increase. Thus the greater the firm’s level of ownership, the greater the control it enjoys over its international transactions.

3.11 Summary

This chapter has provided the theoretical framework and definitions which are relevant to this research and also provides a literature review of the theories which relevant to the research of this thesis. External environment is divided into micro and macro environment. Macro analysis can be carried out by using PESTLE and Porters Five force analysis can be used for micro level analysis. SWOT is a useful tool to analyze the internal environment and integrate the internal and external analysis. Porters generic strategy is found to be useful to suggest the strategies for further growth and to achieve sustainability. For pursuing a competitive advantage Porter identified three generic strategies: a cost leadership strategy, a differentiation strategy and a focus strategy. Firms can choose from one of the three generic strategies to compete in the marketplace, regardless of the context of industry to gain competitive advantage and are closely related to the capabilities and resources the company possesses and uses. PESTLE, Porter’s Five Forces, and SWOT all utilize basic frameworks for reviewing a situation entry modes have a major impact on the firm’s overseas business performance, their choice is regarded as a critical international business decision. The PESTLE analysis is used
to identify forces in the macro-environment that are affecting the business at present and are likely to continue to affect the business in the future. The Porter five force model uses the 5 forces that shape industry structure and competitiveness. These forces are: the threat on new entrants, the bargaining power of suppliers, the bargaining power of buyers, the threat of substitutes and competitive rivalry among the existing competitors. These five major factors determine the intensity of competition in the industry and examines how these five actors influence the competitiveness, and what opportunities and threats they will bring to the company. It contributes for the companies to understand their competitive environment, and create their competitive advantages. The five forces model is used to help the firm analyze whether the industry is profitable, what opportunity and threat it will face in the future. After doing the internal analysis, the firms could integrate their strength and weakness with the opportunities and threats, and then deciding which generic strategies should be taken in this industry. SWOT analysis is a framework links the firm’s capabilities to its relevant competitive environment. I.e. the SWOT analysis focuses on evaluating the strategic position of a firm by analyzing its strengths, weaknesses, opportunities and threats . SWOT helps to determine an organization’s competencies as well as identify future opportunities. It summarizes the key issues from the business environment and the strategic capability of an organization that are most likely to impact on strategy development. In this chapter stages of internationalization of companies have also been reviewed has also described and compared the different international market entry modes available to a firm wanting to enter international markets. As entry modes have a major impact on the firm’s overseas business performance, their choice is regarded as a critical international business decision .The trade off between these modes can be done on the basis of control, resource allocation and risk involved in each type of entry mode. A firm is expected to choose the entry mode that offers the highest risk-adjusted return on investment.