Business Transactions Solutions § 260:81

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Chapter 260. Evaluating Foreign Markets

# § 260:81 Business Counselor's Training Materials: Evaluating Foreign Markets

Globalization requires that companies forge business relationships with parties from different countries, cultures and legal systems. All of these relationships present unique challenges and companies must be prepared respect the differences and the values of the other party as they negotiate and eventually begin to conduct a cross-border relationship. In order for this process to be successful, a careful analysis, popularly referred to as "country analysis", should always be made of the country or countries in which the business activities will take place. Country analysis is a holistic approach to understanding how a country, particularly its government, has acted in the past and may act in the future. A comprehensive country analysis should begin with an evaluation of environmental factors, including all relevant economic, political, legal and cultural factors. The next step is to examine the institutional framework of the target country, a process that focuses first on identifying the national goals and objectives of the country and the various policies the government is pursuing to achieve those targets. The analyst must then evaluate the performance of the country vis-a-vis its national goals and objectives using objective and easily verifiable measures. Other elements of a country's institutional framework that should be considered include the financial system, human capital, legal and regulatory systems, ownership and governance practices, business-government relations and the media. The last, and most difficult, step in any country analysis is constructing scenarios that might represent the evolution and development of the country over the period of concern to the company (e.g., the term of a proposed joint venture). Country analysis is typically discussed in the context of advising foreign investors on whether to launch or expand business activities in a particular country. In addition, however, country analysis is a valuable tool for managers of enterprises already engaged in business activities in the country since those managers will presumably want to create internal business plans and set internal performance goals and objectives and will need to make forecasts about the local environment and the actions of local institutions.

Key topics relating to evaluating foreign markets include collecting information for conducting country analysis; organizational practices for monitoring the external environment; environmental analysis; understanding and assessing the national institutional framework; evaluating management styles and practices; forecasting and scenario planning; market and site selection and presentation of country analysis. This memorandum is intended to help managers and their professional advisors understand organizational practices for monitoring the environment in promising foreign markets; understand how to conduct an environmental analysis of a foreign market; define and describe the elements of a national business system; describe the dimension of the national institutional framework; understand and analyze differences in management styles and practices in foreign markets; understand techniques for forecasting and scenario planning and understand the process of market and site selection.

1. Effective country analysis depends on access to current information about economic, social and political conditions in the particular country and several steps should be taken to implement organizational practices for monitoring the environment in promising foreign markets. First, information programs should be conducted inside the organization to educate other managers and key employees about each relevant environment and the effect it might have on the firm. While the importance of environmental analysis is well known and understood in large organizations, it is a foreign concept for many smaller businesses. Second, a plan should be developed to collect relevant information on environmental factors on a continuous basis. The idea at this point is not to create an overly complex or sophisticated system. Instead, the emphasis is on demonstrating to others how important information can be and how it can be applied in solving day-to-day problems. In order to create the system, all relevant sources of information should be identified, including trade publications, government reports, financial information and business reports published by competitors and online publications. Information generated by the company through its regular activities should not be overlooked, nor should data and feedback from customers and suppliers. Finally, a formal procedure should be established to ensure that the collected information is carefully analyzed on a regular basis to identify and forecast major forthcoming environmental changes that will create new opportunities for, or significant threats to, the firm.

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2. One of the most important steps in deciding whether to conduct business in a foreign market is undertaking a detailed analysis of the unique set of challenges arising out of the particular external business environment in that market. Environmental factors are the external forces (i.e., those that flow primarily from outside the firm) that create pressures, demands and opportunities for the business. While there is no single, or best, way to categorize the multiple factors that might impact the operations of a firm, a useful classification separates and focuses on economic, political, legal, cultural and social, technological and demographic factors. Each of these major categories can, in turn, be further broken down into distinct categories to facilitate a more robust and systematic analysis that includes such things as natural resources, technology, institutions, religion, and population growth and migratory habits.

3. Firms and entrepreneurs must not only cope with their external environment, but must also align their activities with the institutional framework for economics and business, sometimes called the "national business system", that has been created within their country. While complicated definitions of a "business system" are available it is sufficient to acknowledge that "business systems are characterized and differentiated by at least the following constituent features: the different ways of organizing and coordinating transactions, where what is different across different systems is the mix of hierarchical and market organized transactions; different types and levels of specialization ("preference for particular kinds of activities and skills"); the degree of separation between ownership and control, that is to say, the mode of corporate governance; and the organizing principles that influence firm routines and capabilities through their influence on authority relations, organizational structures, relations between the professions, etc.". Diversity of business systems among countries occurs because they are embedded in the institutional context of their countries.

4. It is important to understand the dimensions of a country's national institutional framework. The first one is the "role of the state", which is determined by the political and bureaucratic elites within the country, includes the economic policies selected by the state and the degree to which the state is willing to decentralize economic power to private interests. Governments set national goals and objectives and then support them through foreign policies, fiscal and monetary policies, income distribution and maintenance policies, foreign trade and investment policies, industrial policies, social and cultural policies and political policies. The dominant institutions relating to financial and labor markets, including human capital, are also important dimensions of the institutional framework. As to human capital, states obviously play a key role in skill development through support and oversight of educational systems and through development and enforcement of rules pertaining to the relationship between employers and employees (i.e., union activities and collective bargaining). Legal, regulatory and contracting systems represent attempts by the state to formalize and standardize the rights of participants in economic transactions, property rights and the rules of participation in markets. Ownership and governance includes both models for ownership and management of enterprises—including the distance between owners and managers and the responsibilities of both owners and managers—and the level of reliance on, and basis for forming, networks and alliances to manage risks and share resources. Business-government relations describe the relationships between the state and industry associations that form the basis for distinguishing the various state types described above. Also important is the degree to which the media sector in a particular country performs certain key roles—providing accurate news and information to the public, facilitation of public debate and discussion and serving as a means for holding powerful elites accountable—and the extent to which the state is involved in regulation and restriction of content and access of its citizens to independent sources of news and other information. Finally, consideration must be given to the country's "entrepreneurial ecosystem" and the types of policy initiatives to promote the creation and maturation of high growth firms.

5. When entering into business relationships with parties from foreign countries or setting up a new subsidiary in a foreign country that will be staffed with local managers and employees, it is important to understand the norms and expectations in that country with respect to management styles and practices. While it has been argued that certain management practices and styles have universal appeal and effectiveness, the reality seems to be that there are real and significant differences between countries with respect to their business and innovation systems and their preferences regarding leadership and management styles. These differences are based on a wide range of factors including differences in economic development and macroeconomic characteristics; financial sector development; political stability, democracy and trade bloc membership; colonial ties, language, religion and legal system; attitudes toward authority, trust, individuality and importance of work and family; demographic characteristics; patents and scientific production; and tourism and Internet use.

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6. While most of the initial investigation process during the evaluation of a potential foreign market focuses on the current economic, social and political conditions, companies must also make an attempt to forecast the nature, extent and timing of changes in the business environment that may have a material impact, positive or negative, on the activities of the company in the foreign country. Forecasting methods can generally be broken out into three major categories, including expert opinions or judgments, trend analysis and "alternative options" analysis, the most popular of which would have to be scenario planning. Each method has its own unique advantages and disadvantages, and companies generally rely on two or three methods for forecasting, in many cases relying primarily on monitoring and expert opinions and then using the information to create specific ideas and propositions that might be subjected to trend analysis and scenarios. Regardless of the methods deployed, managers must use sensitivity analysis to challenge the assumptions that form the foundation for each forecast. The use of models allows an analyst to quickly measure the impact of a change in a particular variable. In most cases, proper use of sensitivity analysis will generate alternative pictures of what the future might look like, thereby creating a broader array of choices for managers. One area in which sensitivity analysis can be particularly valuable is when there is uncertainty regarding the actual rate of diffusion and adaptation of a particular product or technology in the foreign market once the decision has been made to move forward with development and commercialization.

7. Once the company has collected information regarding potential foreign markets, a decision must be made regarding which markets are most suitable for the firm and warrant further evaluation and development. It is the rare company that has sufficient resources, financial and otherwise, to simultaneously pursue every promising market opportunity, particularly in the early stages of the company's development when it is considering going global for the first time. Accordingly, procedures should be developed to screen the candidates in order to select those foreign countries, and locations therein, that offer the best chance of commercial success for the company. Market selection must take into account several different factors and requires input from throughout the company. For example, the choice of which foreign markets to pursue clearly has strategic consequences and, as such, input from senior management is always an essential element. In addition, input from finance and human resources is necessary to determine whether the company has, or can obtain, the capital and personnel that will be need in order for the initiative to succeed. Finally, marketing, technical and engineering experts must be able to provide their advice regarding the choices under consideration and the likelihood that the company will be able to achieve its objectives in light of any specific constraints as to budget or timing.

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Footnotes

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