

# A Managerial Framework For Evaluating World Markets For Direct Investment

Dr. Barbara J. Coe, Regents Professor of Marketing, University of North Texas

Dr. Gopala K. Ganesh, Marketing, University of North Texas

Dr. Wolfram Kleinknecht, Ford-Werke AG, West Germany

## Abstract

*This paper presents a managerial framework for improving the quality of the decision making process involved in selection of new foreign markets for direct investment. The framework consists of four profiles: Market Characteristics, Competitors, Firm Capabilities, and, Competitive Parity/Superiority. Weights of individual elements within each of the profiles as well as the profile as a whole can be assigned by managers to reflect the internal and external constraints and requirements of the firm considering foreign direct investment.*

## Introduction

This paper presents a decision framework incorporating four major profiles, for use in evaluating markets for possible direct investment. The profiles deal with market characteristics, competitors, firm capabilities, and, parity/superiority vis-a-vis competitors. The profiles are intended for implementation in a three-phase sequence that ultimately leads to different actionable alternatives for the firm in evaluating potential markets. The paper describes the components of each of the four profiles in detail.

## Selection of Markets for Foreign Direct Investment (FDI)

Foreign direct investment (FDI) is one foreign market entry method that allows implementation of a global marketing strategy. As illustrated by FDI statistics, the presence of companies in world markets abroad is ever-increasing. According to the US Department of Commerce (1987a, p 64), the FDI position of U.S. companies has more than quadrupled in the period from 1968-1986 with the current value of foreign assets held by U.S. firms totaling nearly \$260 billion. In addition, also according to the US Department of Commerce (1980 p 24, 1987b p 96), concurrently, FDI in the U.S. since the late 1970s has sky-rocketed from \$52 billion in 1979 to \$209 billion in 1986, a four-fold increase in less than 10 years. The biggest foreign capital investors in the U.S. include firms from the U.K, the Netherlands, Japan, and West Germany, with a combined share of 64.6% of the accumulated total. Additional statistics from the US

Department of Commerce (1988 p 73) indicate a record increase of \$41 billion in FDI in the U.S. in 1987. The rapid development of FDI in the U.S. has made it a subject of interest in recent research. However, the bulk of research has focused on the development of strategy. With the exception of Bartels (1973), Bradley (1987) and Ragazzi (1973), there has been relatively less attention paid to the selection of the markets to be included in the global marketing strategy of a firm, especially from the practitioner's viewpoint, which is the focus here.

## A Framework for Analysis of Potential FDI Markets

The use of a four-part framework is recommended for evaluating potential FDI markets. An overview of the framework recommended for use in analyzing a country under consideration for FDI is presented in Figure 1. The four integrated profiles in the framework focus on Market Characteristics, Competitors Characteristics, Firm Capabilities, and Competitive Parity / Superiority considerations. The framework is suggested as an analytical technique for use by managers and is intended for improved decision making as it relates to implementation of a global marketing strategy involving FDI in a particular country.

The flexibility in the framework design allows a firm to select the weights for each of the elements which comprise the four profiles. This customized procedure for assigning weights allows realistic reflection of the

firm's product and market characteristics in the current planning time frame as well as taking into account any pertinent unique characteristics, comparative advantages, comparative disadvantages and/or financial parameters. In the later sections, each of the profiles is discussed in terms of the elements which comprise it, potential importance in the market selection process, strategic fit with overall global/foreign expansion goals of the firm as well as fit with the integrative nature of the framework.

### **Integrative Characteristics of the FDI Framework**

The framework is designed to work as an integrated procedure. Each profile builds on information developed in a previous profile and synergy is achieved through the interaction. Phase One of implementation of the framework consists of developing two profiles that deal with the comparison of characteristics of the markets under consideration for direct foreign investment and the comparative strengths and weaknesses of competitors already in these markets. The markets under consideration may be defined as a set of countries, a single country, or a region within a country. The strategic fit of the competitors with the market is of special interest in this stage of framework implementation. The closer the fit, the more difficult it may be to successfully penetrate the new market. The analysis in Phase One seeks to identify specific requirements for success in the market based on market characteristics, how well the market is being currently served and analysis of competitors.

Using data from Phase One, Phase Two involves the development of the third profile. This profile deals with an assessment of the firm's capabilities as well as evaluates the likelihood of meeting the perceived success criteria and competing effectively with already present competitors. Consideration of any existing interaction between the market and competitors already present, on the one hand, and the potential means through which the firm can seek to affect, change and/or capitalize on this interaction, on the other, is the focus of this phase. Such an analysis results in the development of the fourth profile, which reflects the areas of parity and superiority the firm would have if they chose some form of direct investment in the market under consideration. The Competitive Parity/Superiority profile could help the firm assess the likelihood of adding a market to its international or global market portfolio. It also reflects the integration of elements and data from the three earlier profiles and the conclusions arrived at based on this integration.

Phase Three involves a careful analysis of the elements in the Competitive Parity/Superiority Profile. Once the analysis is satisfactorily completed, management is in a position to make a "go" or "no go" decision relating to foreign direct investment in a particular country market. If management is unable to arrive at a decision, it is likely the result of a breakdown occurring at some point in the analysis involving one of the three phases of implementation. Careful development, implementation and interpretation of each profile can guard against this occurrence. Hence, each of the profiles is discussed in detail in the following sections.

### **Market characteristics profile**

The Market Characteristics Profile, illustrated in Figure 2, describes the current nature of the market under consideration for FDI. The elements, which should be included in the profile can be categorized as those not controllable by any one firm and those elements that are controllable but subject to competitive impact, flexibility and change.

#### *Non-Controllable market elements:*

Entry barriers, current market conditions, exchange rates, and legal environments are all viewed as possible non-controllable elements in a potential FDI market. Entry barriers may be regulatory, technological, or cultural in nature. These barriers are important because of the role each plays in determining who has a chance for success in the market place. In some circumstances, these barriers even determine who will be given a chance to enter the market.

While market conditions can be altered in the long run, current market conditions represent the given environment the firm would be entering, if that market is chosen for FDI. Analysis of these elements also provides some insights into the types of strategies which would be necessary if the firm wishes to alter the nature and direction of the evolution of the market. Such considerations take on additional meaning later in the framework when firm capabilities and parity/superiority vis-a-vis competitors are considered.

The exchange rate is a critical factor in determining the affordability of entering and operating in a market as well as the cost of resources and products and services sold in the market. Impacted by central banks, world conditions, and foreign policy factors, overall patterns of movement in foreign exchange rates are more meaningful to the firm than simply looking at the current rate.

# Foreign Direct Investment Market Analysis Framework

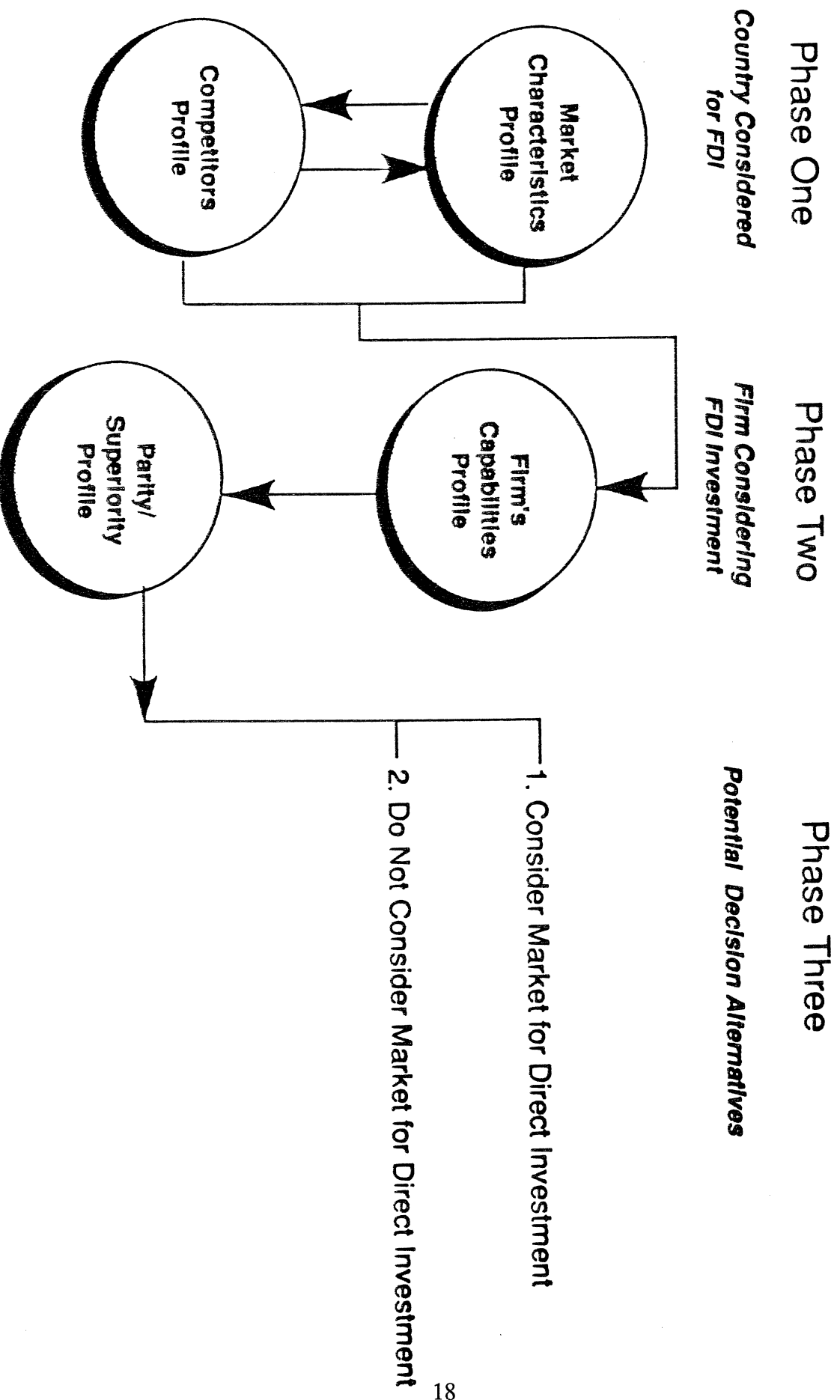
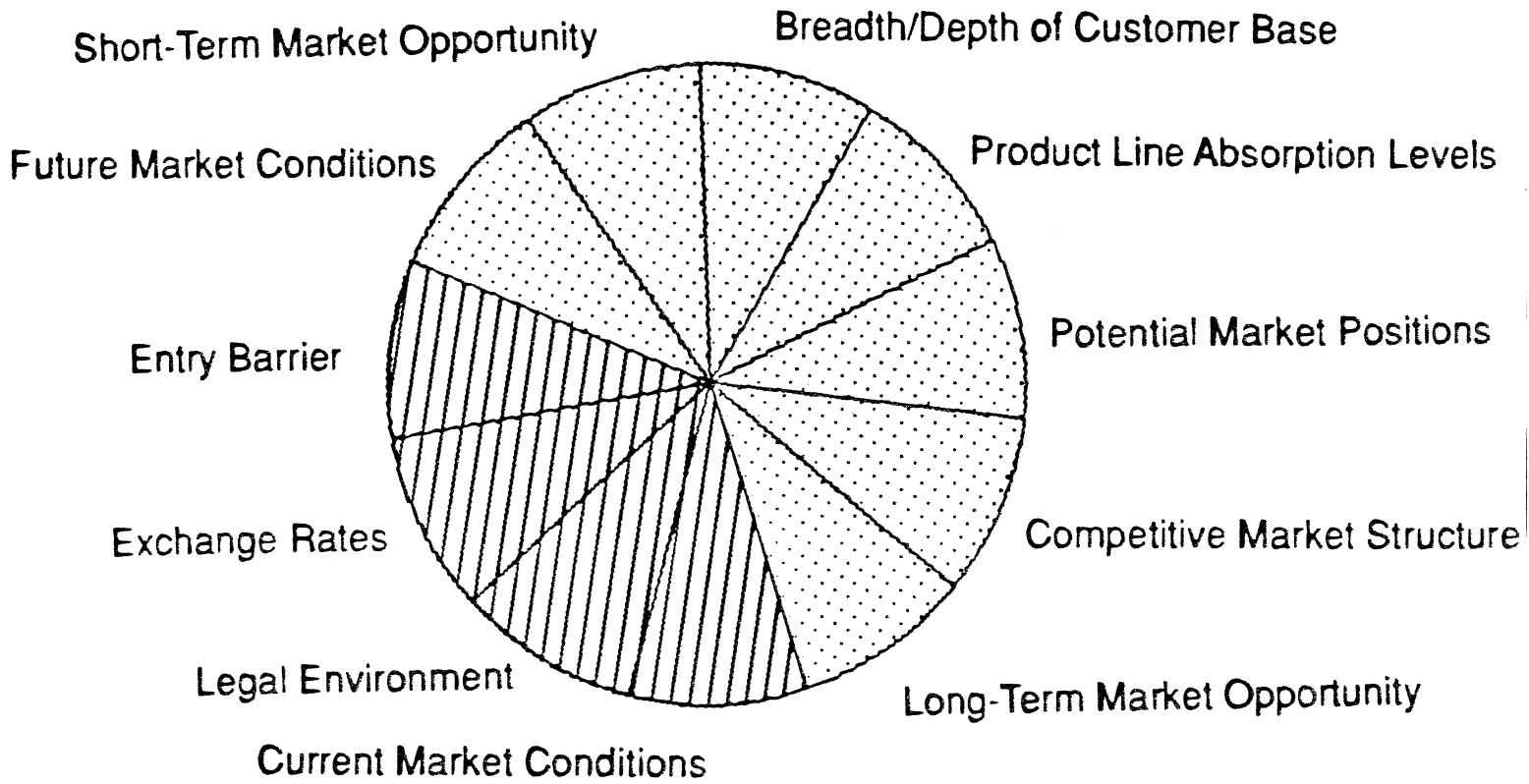


Figure 1

# Market Characteristics Profile



 ***Non-Controllable Market Elements***

 ***Impactable Elements***

**Figure 2**

The volatility of this element represents the greatest potential for turning what is perceived as a good market entry decision into a serious mistake. The reality is that in some cases no amount of planning and analysis can necessarily hedge against risks in exchange rate movements.

Legal environments in markets are generally stable over time except in the following circumstances: 1) when there has been a major change in ruling parties or governments, 2) when there is a strong movement for protectionism and trade barriers, and, 3) when local industries feel threatened by potential foreign competition. As in the case of exchange rates, the pattern of change in legal parameters, rather than current legal environment, should be the focus of data gathering and analysis.

#### *Controllable elements:*

Perceived impactable elements are the focus of both competitors' and a firm's own marketing efforts. The impactable elements include short-term and long-term market opportunity, competitive structure of the market, expected future market conditions, potential positions available in the market, product line absorption level for the types of products/services planned by the firm, breadth and depth of customer base, and, available market sectors.

Short-term and long-term market opportunity define the demand potential on which calculations of market share, profitability and return on investment rest. The interaction between these elements and the competitors' possible actions, considered in the Competitors Profile later on, impacts the attractiveness of the market as compared to other opportunities the firm may be considering for FDI. Since most firms face limited resources for market expansion, the nature of the market opportunities are of vital concern in the eventual investment decision. Competitive structure of the market and expected future market conditions are interrelated elements which define the parameters within which market opportunities will be pursued. Increases and decreases in the number and size of competitors will directly impact the likelihood of successful pursuit of a market opportunity.

Types of market positions that are possible are directly linked to the likelihood of FDI success. In a crowded market, where only a follower position is likely, such an investment is questionable unless a firm can afford to commit significant resources. The interac-

tion among market opportunities, the level of competition and current positions held impact this important element. Though controllable to some extent, it may represent an entry barrier in some potential FDI markets. Information from the Competitors Profile, described later, can be useful in determining the likelihood of achieving a desirable position.

Product line absorption refers to the number of different product lines currently available in the market as compared to the overall demand for the product category. If the only possibility of success depends on dislodging existing product lines, a strategy requiring significant investment of resources may be the only alternative.

The stability and growth potential of the customer base in the market is the major element in the demand equation. Current levels of saturation of the customer groups in terms of product/service choice alternatives, perceived satisfaction, and willingness to consider alternative products are key analytical points. The ability of the market to support additional suppliers is significantly impacted by this customer related element.

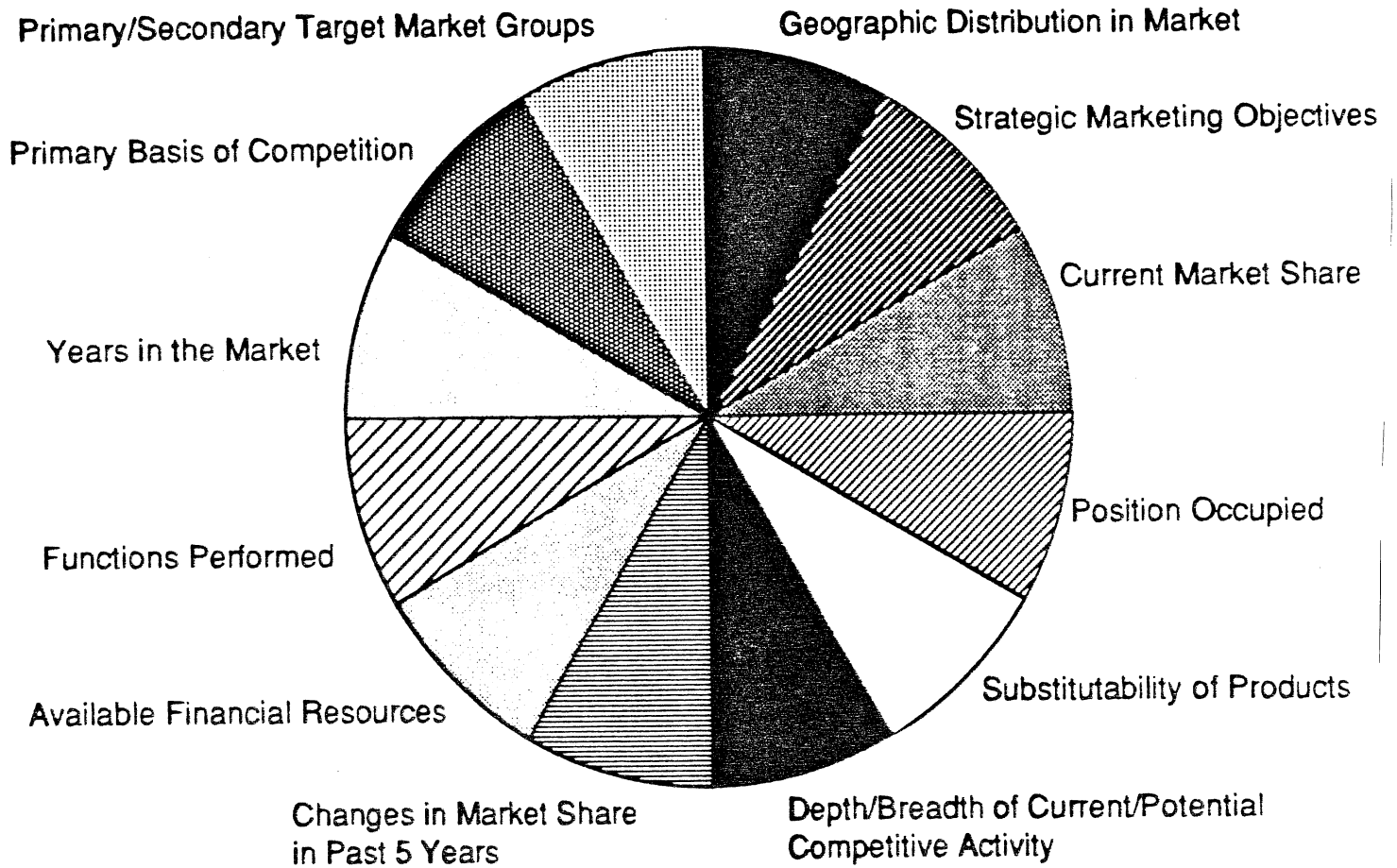
#### **Competitors profile**

The eleven elements in the Market Characteristics Profile are interdependent with many of the elements in the Competitors Profile. This profile, illustrated in Figure 3, describes the supply side of the potential FDI market. The twelve elements included in the profile may be analyzed for all competitors as a single group or separately for domestic and foreign competitors. Regardless of which of these two approaches is used by the firm, this profile is interdependent with the Market Characteristics Profile.

Twelve elements are important in analyzing the potential competitors. These include: years in the market, position occupied, current market share, changes in market share in past five years, primary basis of competition, depth/breadth of current and potential competitive activity, strategic marketing objectives, substitutability of products/services, geographic distribution in market, primary and secondary target market groups, functions performed, and financial resources available for market.

Years in the market provide information on the commitment of the competitor to the market and its staying power. The position the competitor now occupies reflects the successes or failures achieved given the

## Competitors Profile



*Domestic and Foreign Competitors*

**Figure 3**

years in the market and resources invested. These two elements can be studied to determine the size of the investment the firm may have to support, the necessary length of time to achieve a desired market position, and, the nature of the entrenchment of the major competitors to be faced. Entering the market against established leaders represents a serious challenge to strategists and those charged with allocating resources. Therefore, it is important to be objective in recognizing the positions major competitors occupy.

Analysis of current market share and changes in market share over a suitable time period provide insight into the level of share associated with specific resource investments and position held. Determination of what is a suitable time period for the analysis in a specific market involves consideration of such variables as dynamics of the market place, stability of the government in the geographic area, changes in legal and cultural norms, and availability of written records. In the U.S., five years is the norm for such analysis. But, in many markets, especially those just emerging, the five year time period is not realistic or possible, for the reasons stated earlier. In such situations, the appropriate time period must be determined on a market by market basis. The analysis of these first four elements in the Competitors Profile will provide an initial picture of the dynamics of the market under consideration and relate back to the situation identified earlier in the Market Characteristics Profile.

Development of a composite of the bases of competition utilized by the major market competitors, the fifth element in the profile, will provide the foundation for later development of the Firm's Capabilities Profile. In addition, this element also contributes to an understanding of the factors driving the customer base element in the Market Characteristics Profile, discussed earlier. The competition element is also related to the depth and breadth of current/potential competitive activity. The two elements are not considered as a single element due to a concern that basis of competition would become a surrogate for all competitive activity when in fact such activity has many facets beyond basis of competition. Separate treatment also follows from its importance in understanding the link between benefits sought by the potential customers, positioning by various competitors, and ultimate success or failure in terms of penetration of the market.

Competitors' long term thrust and direction are reflected in the strategic marketing objectives each has developed for the market. These objectives can be

studied to determine likely reactions of competitor firms to objectives and strategies utilized by an entering firm. The objectives can also serve as indicators of the seriousness of individual competitors about the market and their global marketing plans. The absence of strategic marketing objectives in such plans is often a sign of the competitors' instability in the market under consideration. This instability may represent an opportunity for the firm considering entry as well as other competitors.

If a competitor's product is perceived as a direct substitute for one or more of the firm's products to be introduced into the market, the challenge of developing strong comparative advantages will have to be met. Customers will have to be persuaded to try the "new" product entry at the expense of competitors' equivalent products. Strategy development will require creativity and the investment of significant resources over a prolonged period of time if there is to be a chance of success. Differentiated lines are more likely to succeed.

The geographic distribution of the competitors in the market reflects their ability to efficiently serve the various primary and secondary target customer groups. These two elements (distribution and target customer groups) of the Competitors Profile provide insight into the nature of saturation in the market and the demand characteristics identified earlier in the Market Characteristics Profile. Flexibility in targeting unserved customer groups or unserved geographic areas may be identified through these two elements and serve as market opportunities.

Functions performed in the market, especially by foreign firms, indicates the depth of the commitment to the market. In addition, information on this element can lead to the identification of opportunities and functions not satisfied, which may be exploited by the FDI firm if it chooses to enter the market. This element is especially important in development of the Competitive Parity/Superiority Profile later on. The financial resources element is one of the most vital in predicting the reaction of various competitors to the entry of a new firm into the market. Financial resources influence the ability to react, the ability to grow, and the staying power of a competitor. In addition, this elements reflects the ability of the competitor to perform effectively in many of the areas covered by other elements in the Competitors Profile.

Based on the development and analysis of the Market Characteristics and Competitor Profiles, the firm is in a

position to analyze its own potential for successfully entering the new market through the development of the Firm's Capabilities Profile.

### **Firm's capabilities profile**

The Firm's Capabilities Profile, illustrated in Figure 4, provides a review of the strengths, weaknesses and experience of the firm. Six of the ten elements in the profile focus on the firm's experience in its domestic market. The remaining four elements relate to the firm's Foreign Direct Investment experience. If the firm has not had any direct foreign investment experience, the profile would be limited to the first six elements.

#### *Domestic market elements:*

The firm's resource base, position held in the domestic market, size and depth of staff, priority product lines, specific capabilities in key success areas, and years of experience in the market comprise the first six elements in the profile. The data for this profile can be developed from internal accounting and marketing records as well as from interviews of key headquarters staff and line executives as well as people in the field. If, as in most firms, there is continuing competition for resources, an analysis of already committed resources provides insights into priorities existing in the company and what future resource may be available for expansion strategies. Available resources can be compared to what potential competitors have invested in the market under study. This analysis will provide vital input for the fourth and final Competitive Parity/Superiority Profile that will be discussed later. A strong parity/superiority position held in the domestic market may be useful in a new FDI market. A firm successful in its own domestic market may use this as a symbol of strength and experience in justifying why customers, in a new market, should consider purchasing the new product or service. Years of experience in the domestic market is often an important indicator of the ability to use already developed strengths in expanding into foreign markets. Such strategies have been used successfully by German, Japanese, and Swiss firms in the U.S. market and U.K., Japanese, Korean, and U.S. firms in Western Europe.

Size and depth of staff speaks to the availability of human resources for initial expansion into a new market. Depth is especially relevant given the need to support current as well as new markets. Priority product lines may or may not be candidates for expansion into the new market. If such lines are candidates, the similarity between the important attributes and specific uses of the

product in the domestic versus the proposed market should be analyzed.

The comparative analysis of domestic market elements would be dependent on information from the first two profiles as well as information generated for the Firm's Capabilities Profile. One of the most critical elements for the development and use of the profile is the objective evaluation of the firm's specific capabilities which have brought it success in the domestic market. The capabilities would include expertise and innovativeness in product development and modification, pricing, distribution, and various types of promotion. For a service based company, personnel, physical facilities, and process management may also be included in the analysis. Results from this analysis are the most important inputs for the development of the final profile.

#### *Markets where firm has FDI experience:*

If the firm is already pursuing a direct foreign investment strategy in one or more markets, four additional elements will be included in the third profile. The first will be the number of current FDI markets. This information is an indicator of the span of management and investment of resources the firm is already committed to. The second element focuses on identifying the goals which have been developed and carried out in the FDI markets. Several important questions need to be addressed here viz: Are there goals still to be met? How does the market under consideration potentially contribute to these goals? If the firm has no formal goals, it will be difficult to evaluate potential FDI opportunities.

Years of experience in the existing FDI markets and the degree of success achieved, the third and fourth elements, serve as indicators of how much and whether supervision of these markets is still needed, what level of resource allocation is still required, and, which skills have proven successful and might be transferred to a new FDI marketing opportunity. The number of FDI markets in which the firm has been active is also an important indicator of experience.

Results of the analysis of the elements in the Firm Capabilities Profile, as well as information from the Market Characteristics and Competitors Profiles, provide the inputs for the fourth and most critical of the profiles, the Parity/Superiority Profile.

### **Competitive parity / superiority profile**

In this profile, illustrated in Figure 5, the results of



# Firm's Capabilities Profile

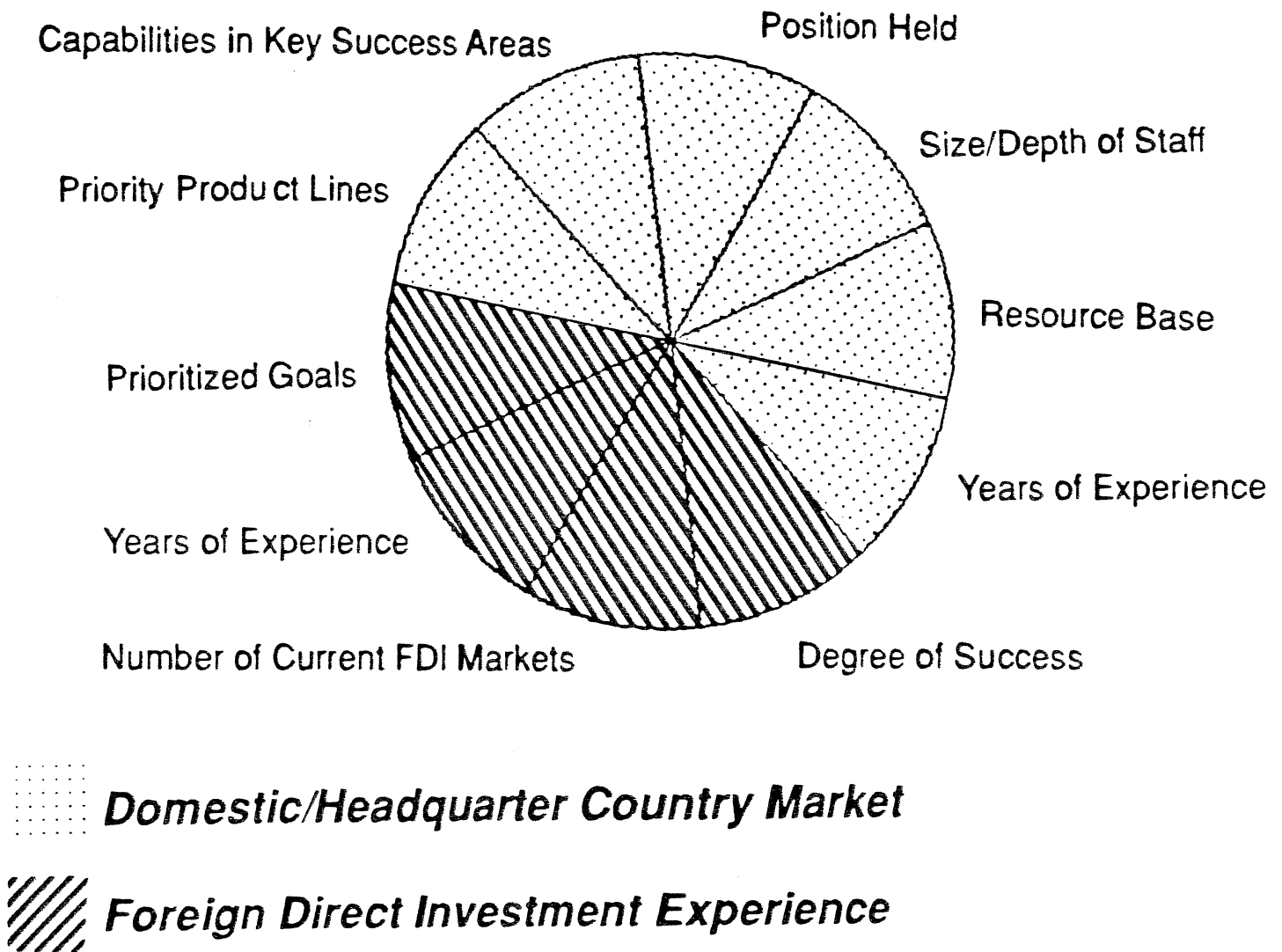


Figure 4

the three previous profiles are utilized in an analysis to determine if the firm has a parity or superiority position in key areas associated with potential success in FDI strategies. The elements in the profile are divided into two groupings. The first grouping, consisting of six elements, focuses on existing areas of superiority. The second grouping, consisting of five elements, focuses on areas where it may be possible to develop parity and superiority.

Present parity and superiority are determined through a comparison of select elements from the Competitor Profile and the Firm's Capabilities Profile, as shown in Exhibit 1. Potential areas for parity and superiority are identified through an analysis of select elements from the Market Characteristics, Competitors, and Firm's Capabilities Profiles.

Development of the Competitive Parity/Superiority profile leads to Phase Three of the framework, where a decision on Foreign Direct Investment is made. Here, there are numerous possibilities for assigning weights to the elements within each profile, as well as to each of the four profiles as a whole. For instance, the firm could rate each of the elements in each of the profiles on a 0 to 100 scale with a higher score reflecting a more favorable or stronger position. The elements could then be combined, for example, in a linear fashion with equal or unequal weights, to arrive at a profile score for that profile. The four profiles themselves could then be combined using weights to arrive at a total score (which would range from 0 to 100) for the foreign market under consideration. These calculations could be considerably speeded up using spreadsheet software. For instance, markets could be listed as rows and each element within each profile as the columns. This would also permit "what if" or sensitivity analysis by changing the weights assigned to elements or the profiles.

### Summary

This paper introduced a framework that could be used by corporate and marketing management for improving the quality of their decision making process as it relates to the selection of new foreign markets for direct investment. The framework is made up of four profiles: Market Characteristics, Competitors, Firm Capabilities, and, Competitive Parity/Superiority. It provides a systematic, organized method for evaluating potential FDI opportunities. Use of the framework offers several benefits to a firm considering markets for FDI investment. These are:

- 1 It heightens the awareness and understanding of the interaction between the market, competitors, and firm's uniqueness in determining whether a perceived FDI opportunity is really for the firm, or only for the industry.
- 2 It increases the ability of the managers to identify the key areas which are necessary for achieving success and the firm's own capabilities in these areas as compared to competitors.
- 3 It focuses attention on the critical areas of resources available, span of management, depth of staff, the objectives of FDI, the demands of already existing commitments, and, responsibilities which would be acquired if the FDI strategy is pursued in a specific market.
- 4 It assists in ranking potential FDI markets through the use of a common set of criteria.

### References

- 1 Bartels, R. (1968), "Are Domestic and International Marketing Dissimilar?" *Journal of Marketing* (July), 56-61.
- 2 Bradley, M. F. (1987), "Nature and Significance of International Marketing: A Review," *Journal of Business Research* (15), 205-219.
- 3 Ragazzi, G. (1973), "Theories of the Determinants of Direct Foreign Investment," *International Monetary Fund Papers* (20), 471-498.
- 4 U.S. Department of Commerce (1980), "U.S. Foreign Direct Investment Position," *Survey of Current Business* (August), 24.
- 5 \_\_\_\_\_ (1987a), (August), 64.
- 6 \_\_\_\_\_ (1987b), (August), 96.
- 7 \_\_\_\_\_ (1988), (August), 73.

# Parity/Superiority Profile

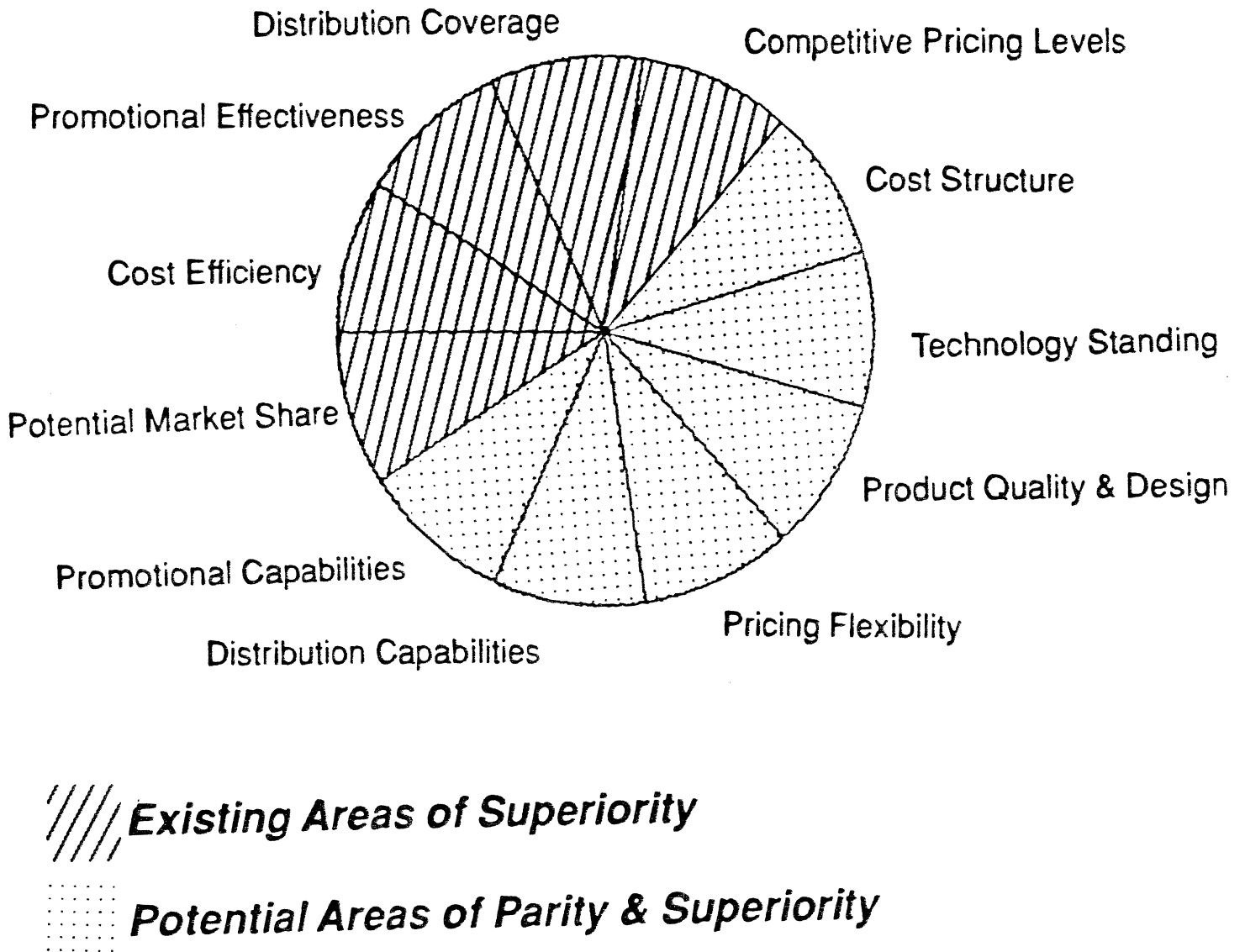
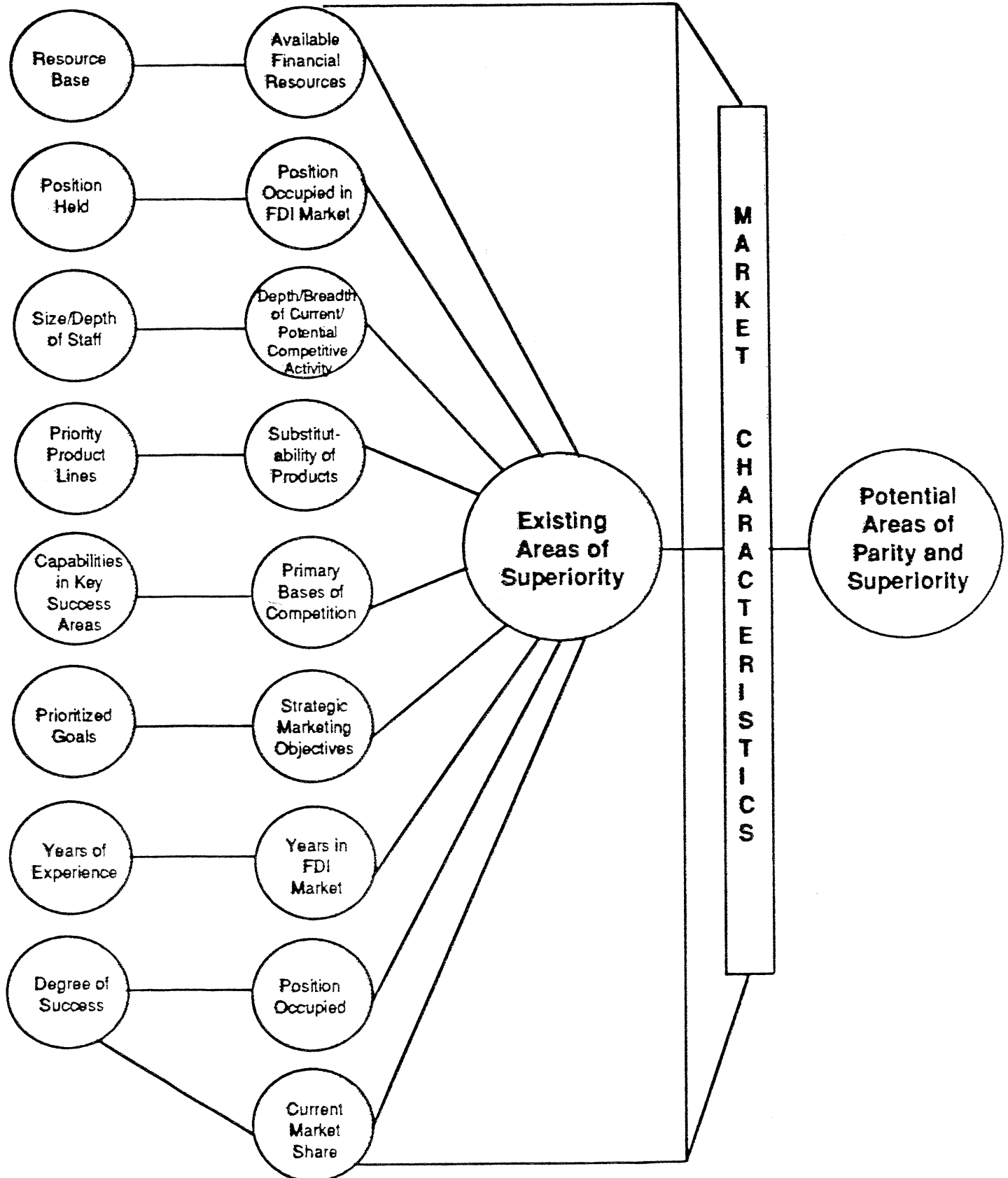


Figure 5

# Identification of Existing and Potential Areas of Parity and Superiority for FDI Markets

**Firm's Capabilities**

**Competitors Profile**



**Exhibit 1**