International Strategy and its Redefinition in the Context of the Economic Crisis: Insights from a Study of Basque Firms

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Abstract

Over the last three decades there has been a spectacular acceleration in the globalization of the economy. With domestic markets facing stagnation and/or saturation, internationalization is essential for firms in advanced countries to preserve and enhance their competitiveness. Since firms worldwide need to adapt to this new reality, an opportunity to review, adjust and/or change their internationalization strategies seems timely.

In this paper we examine how the economic crisis and the emergence of a new world order is challenging previous internationalization strategies of firms, and how new ones are emerging. We highlight how recent research is challenging established frameworks in internationalization theory. Firstly, the notion of being ‘born global’ brings into question the idea of a gradual internationalization of the firm. Secondly, regarding geographic expansion, it is generally accepted that internationalizing firms focus first on their nearest markets (in terms of psychological distance). However, the recent growth of the so-called BRICS has pushed firms to expand into markets, which are more culturally distant. Third, we review the literature on the drivers of internationalization.

Taking the aforementioned review into account, we conduct an in-depth analysis of the internationalization strategies of eight Basque firms over time, focusing on how the current economic crisis is affecting their performance and how they are reconsidering their strategy in the light of the new world order. Our analysis shows that both in terms of exports and foreign direct investment (FDI) most of them are still too centered on the European market, with serious consequences in an era when European markets are stagnating. Those firms that show higher levels of geographical diversification will overcome the effects of the economic crisis more quickly and reinforce their competitive position thereafter. In terms of drivers of internationalization, contrary to the common view that firms internationalize for the sake of efficiency, we find that accessing new markets is the main driver, although it coexists with efficiency and knowledge drivers in some cases.
International strategy and its redefinition in the context of the economic crisis:
Insights from a study on Basque firms

INTRODUCTION

The internationalization of the economy experienced a spectacular acceleration in the mid-1980s, with growth in international trade surpassing world economic growth rates. Capital movements showed an even higher rate of growth than international trade, pushing the theme of globalization to the top of the economists’ agenda (Orkestra, 2011; cf. Friedman, 2005). In an increasingly open and globalized world, with unprecedented levels of international trade and mobility of capital and human resources, and with domestic markets in a state of stagnation and/or saturation, internationalization has become necessary for firms in order to preserve or improve their competitiveness.

The Basque economy (Spain) is not immune to the globalization phenomenon. With a population of 2,200,000, and a shrinking domestic market, its firms must internationalize in order to survive. Indeed an important number have already initiated the internationalization process, participating in international trade and international capital flows both through exports and the establishment of commercial and/or productive plants abroad. However, just as many have still to make the leap into international markets.

Van Agtmael (2007) was among the first in the field to refer to the 21st century as the century of the emerging economies. And with every milestone of the global financial crisis: the subprime crisis in July 2007, the fall of Lehman Brothers in September 2008, and the sovereign debt crisis in Europe; these economies have gained in importance. With the West at the epicenter, it has increasingly looked to emerging countries as sources of finance and growth in order to get over the crisis. In this new world economic scenario, it is foreseen that emerging countries will account for most of the world economic growth in years to come.
Since firms and economies need to adapt to this new reality, it is appropriate that they review, adjust and/or change their internationalization strategies. The paper is organized as follows. In the literature review we analyze trends in the study of the internationalization processes of firms and how they are being challenged by the present economic landscape. In the empirical section we present our methodology and summarize the main findings from our case studies. In the final section we draw conclusions from our findings and discuss the main implications for redefining internationalization strategies of firms.

**FIRMS’ INTERNATIONALIZATION PROCESS: A LITERATURE REVIEW**

In recent decades, considerable research has analyzed the internationalization process of firms. Among other issues, researchers have focused on understanding the stages in the process, the geographic dimension and the drivers of internationalization.

**Stages in the internationalization process of firms**

The dominant idea is that only those firms that have demonstrated competitiveness in their domestic market will achieve success in the international sphere (e.g., Johanson and Wiedersheim-Paul, 1975). For example, recent work on exporters in the service sector in Spain found that exporter firms were more productive than non-exporter firms before they started exporting (Minondo, 2011).

The Uppsala model (Johanson and Vahlne, 1977; 1990) postulates that firms take a gradual internationalization approach, increasing the resources they devote to a country as they acquire experience in that market. Accordingly, firms go through four stages when entering a foreign market, moving from lower to higher degrees of commitment: (1) sporadic or non regular export activity; (2) exports through independent representatives; (3) establishment of
commercial branches in the foreign country; (4) establishment of productive units in the foreign country.

Although the majority of firms consolidate their position in local firms before initiating the internationalization process, an increasing number (either from ‘birth’ or as fledglings) with little experience in foreign markets are opening plants abroad, either fully-owned or as joint-ventures (the so-called ‘born global’), casting doubt on this theory (see, for example, Madsen and Servais, 1997).

**Geographic expansion of firms**

Regarding international expansion into new markets, the creators of the Uppsala model (see Johanson and Vahlne, 1977; 1990) introduced the notion of ‘psychological distance’ to refer to differences such as language, culture, politics, levels of education and industrial development. In his CAGE model, Ghemawat (2001) considers four attributes: cultural distance (religion, race, social norms and language); administrative or political distance (colony-colonizer relationships, common currency and trade agreements); geographic distance (physical distance between two countries, size of the objective country, access to waterways and oceans, internal orography, transport and communication infrastructures); and economic distance (wealth disparity between the two countries and variations in costs and quality of financial and other resources). The author explores how (and to what extent) different types of distance impact diverse industries and shows that explicitly considering distance can dramatically change a firm’s strategic options.

According to this theory, in the initial phases of the international expansion process firms opt for markets with a smaller psychological distance, also called ‘natural markets’, as these represent less risk to the firm. Natural markets are defined by Casanova (2009) as those that share language, history or are geographically close. As firms acquire international experience
through these markets, their international expansion will target other locations with greater psychological distance, while taking into consideration aspects such as market size or global economic conditions (Davidson, 1980). However, based on the study of large multinationals and the debate on their geographic expansion, some have questioned whether firms globalize or simply concentrate their expansion in specific regions (e.g., Rugman y Verbeke, 2004; Dunning et al., 2007).

In recent decades the geographical centre of gravity for business is shifting from the established triad of Europe/US/Japan to the ‘so called’ BRICS (Brazil, Russia, India, China and South Africa). At the end of the 1980s (Ohmae, 1987), 70% of world GDP and 75% of world trade was concentrated among the triad, but over the last three decades this has changed. The BRICS are garnering a rapidly growing share of global Gross Domestic Product (GDP), moving from 11% to 16% in 2000, and currently around 25%. This trend is expected to continue, with the BRICS forecast to account for 40% of global GDP by 2050.

In 2010 China was already the second largest economy in the world, Brazil seventh, India tenth and Russia eleventh. By 2050 the BRICS are projected to make up four of the five largest economies in the world: China in first place, India in third, Brazil in fourth, and Russia in fifth, with the USA in second place to complete the top five. Furthermore, BRICS countries are becoming increasingly important players in global trade flows. While in 2000 these countries accounted for 6% of global trade flows, this increased to 15% by 2010 (Wilson et al., 2011). Geographical patterns of Foreign Direct Investment (FDI) flows are also changing. In 2010, and for the first time in history, developing economies absorbed about half of global FDI (UNCTAD, 2011).

These recent trends have implications for the internationalization of firms in developed countries in general, and Basque firms in particular, as they underline the need to move out of
traditional natural markets, mainly Europe for the Basque firms to new markets in order to maintain competitiveness.

**Drivers of internationalization**

In an attempt to understand why multinational firms exist, Dunning (1988) integrated in his theory the determinants of foreign direct investment (FDI). His general framework explains not only the causes of FDI but its distribution among different countries. Dunning accounts for the multilocalization of firms in terms of three factors. Firstly, a firm needs to possess some *ownership advantages* to serve some markets in comparison to local firms. These can emerge because the firm possesses proprietary rights, intangible assets (firm structure, organizational capacity, teamwork, know-how), size, diversification and/or scale economies, among others. Secondly, the firm must profit from exploiting its advantages instead of selling or hiring them to a firm localized in another country (*internalization advantages*). Thirdly, it may be profitable for a firm to localize part of its production plants abroad depending on the attractiveness of certain locations due to factors that are not transferable across borders, such as resource endowments, price, quality and productivity of labour, and transportation costs. Eclectic theory postulates that the configuration of these three parameters is contextual – that is, it will depend on the economic and political conditions of the country of origin and destination, activity of the firm, and the motives for FDI: whether in pursuit of markets, resources, efficiency or strategic assets (Dunning, 1993). Based on this model, recent work has examined Spanish firms’ drivers for internationalization in different regions (Galán et al., 2007). Changes in motives for investing in different locations have also been analyzed (e.g., Dunning, 2009).

Traditionally, the main motive for firm internationalization was in pursuit of efficiency – to maximize profit from low production costs in developing countries – together with the search
for foreign markets with potential for growth. According to Doz, Santos and Williamson (2001), in the present knowledge economy, traditional multinationalization strategies are not sufficient to differentiate a firm from its competitors; since knowledge is no longer located in a single place but dispersed all over the world, firms need to internationalize in order to acquire knowledge from other locations. Thus an additional motive for internationalization is the search for knowledge, notably the establishment of manufacturing and R&D activities in places that offer a favorable ecosystem for innovation, which allows firms to innovate and maintain their competitive advantage.

However, products and services may need a degree of local customization to align with local purchasing power. Whereas in the West new products are typically targeted at a vanguard of high-end/technology savvy consumers as these are the most experimental, and often the most demanding, and only become mainstream in a second stage, in many emerging countries the most experimental consumers are often among the lower echelons of the market pyramid. Hence it is these consumer groups that are most inducive to innovation.

In a double sense then, those customer segments function as a trampoline for what is often called «reverse innovation» (Govindarajan & Ramamurti, 2011) – reverse in the sense of developing innovations and new products first for entry-level consumers and only later adapting them for more sophisticated users. And reverse in the sense of first for emerging markets and afterwards for the so-called advanced economies. The latter represents a rupture with classical international product life-cycle thinking (Vernon, 1966), which assumes that products first serve Western markets, and that once these are saturated companies will look to less advanced countries for their product offering.

In sum, adding to Dunning’s eclectic paradigm those aspects highlighted in Doz et al.’s work, the multinationalization of firms may be explained in terms of four advantage groupings: (1) ownership advantages, (2) internalization advantages, (3) localization advantages, and (4) knowledge and innovation. The two first refer to internal capacities of firms, competitive
advantages that firms are willing to exploit in foreign markets, whereas the latter two refer to external factors that firms seek to exploit through internationalization. Based on these, four different drivers for firm internationalization can be distinguished: (1) *efficiency seeking*, especially in terms of availability and price of labor, logistics and price of inputs needed to install and run a plant, (2) *access to new markets* which the firm could not access from the home country for various reasons (costs, logistics, regulations, etc.), (3) to *guarantee resources* (human or natural), and (4) a *search for learning and innovation* (see Figure 1).

**FIGURE 1. DRIVERS OF INTERNATIONALIZATION**

![Diagram showing drivers of internationalization]

Source: Authors own elaboration based on Dunning 1988 and Doz et al., 2001.

**AN EMPIRICAL STUDY: INTERNATIONALIZATION OF BASQUE FIRMS**

In this paper, we study the internationalization process of eight firms in order to obtain insights into how firms internationalize and how internationalization strategies are changing in the light of recent trends in the world economy. Our ultimate aim is to identify good practices, and make recommendations for firms to redefine their internationalization strategies in order to maintain their competitiveness in a changing environment. For that purpose we have followed a similar methodology to that applied by Casanova and Fraser (2009) in their work on Latin American multinationals. Our in-depth analysis focuses on the study of: (1) stages in the internationalization process, (2) the geographic dimension of
internationalization, and (3) drivers for internationalization. We obtained information on the eight firms based on primary sources with interviews of authors with senior managers of firms\(^1\) as well as secondary sources such as annual reports, firms’ web pages and other public information as well as previous cases studies on firms and press articles.

We selected a varied sample of firms in terms of size, different sectors of activity, headquarters located in different provinces, with medium-to-high internationalization level. We defined as multinationals those firms with production plants and/or Research and Development (R&D) centres outside Spain – i.e., firms that went a step further than exports or commercial subsidiaries in the internationalization process. (Appendix 1 summarizes the main characteristics of the selected firms).

**Stages and geographic expansion process of internationalization**

According to the model presented in the theoretical section and given its geographical proximity and similarity in terms of industrial development and educational level, the natural market of the Basque country should be Europe, followed by Latin America due to cultural affinity. Expansion to Asia would be the last step in the internationalization process as it represents unknown markets and a vast distance both in terms of geography and culture. According to data on foreign trade and FDI of the Basque Country and our case studies, Basque firms seem to follow this model.

As shown in Appendix 1, all the analyzed firms export to Europe. Firm 1 only exports to Europe, while the rest also export to America and Asia. Five of the firms (Firms 2, 4, 5, 7 and 8) sell their products in all continents. 87% of firm 4’s exports go to Europe, while Firm 8 concentrates two thirds of its sales in the same continent. Firms 2, 3 and 5 present a higher geographical diversification in sales. Firm 2 sold 12% of its products to the rest of Europe in

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\(^1\) The cooperation, suggestions and comments of the executives in the eight firms studied for this paper is gratefully acknowledged.
2011, 17% in other OECD countries, and 46% in other countries. The turnover of firm 3 is divided between Europe (47%) and America (30% Brazil, 18% NAFTA), while it sells only 1% of its products to China. In the case of firm 5, 23% of its sales in 2011 went to China, 19% to India, 15% to Latin America, 14% to the USA, 20% to the rest of Europe, and 1% to the rest of the world. At a time when Western markets, especially European ones, are in stagnation, diversification of sales is an important asset for the competitiveness of firms.

Regarding FDI, most of the Basque country’s FDI is concentrated in Europe, followed by the USA. That is, the international expansion of Basque firms is focused on advanced countries. However, in the case of the firms in this sample, we do not observe such a clear concentration, with a strong presence in some cases in Latin America (especially Brazil and Mexico), and a greater presence in Asia, mainly China than the general data for the Basque Country shows, especially in the case of firm 5.

As may be expected, there are important differences in the degree of the eight firms’s geographic expansion. While in terms of exports many of the firms reach a global scale, in terms of production their degree of international expansion is lower. Firm 7 has consolidated production plants in Europe, America, Africa and Asia. Firm 3 also has production plants in four continents, although more concentrated in Europe, both East and West, and America (Brazil and Mexico). Firm 5 also has a global scope, with a strong presence in Europe, the USA and China, and an increasing presence in India and Brazil. While the rest of the firms present a high degree of internationalization in terms of trade, they have production plants in a smaller number of countries. Firm 8 manufactures in Europe and the USA. Firm 4 concentrates most of its production in Europe, although it is also present in Africa (Morocco) and Asia (China). Firm 1 forms a bridge between China, where it manufactures, and Latin America, where it designs its products. Firm 6 has a commitment to investing in emerging countries, with an important presence in Mexico and recent entry into India. Finally, the
foreign production plants of firm 2 are concentrated in America, both USA and Latin America.

Drivers for internationalization: Crisis as an opportunity

In the macroeconomic context, Spain’s entry to the European Economic Community (EEC) in 1986 represented a radical change in the rules of the game for Spanish firms. Hitherto, they had enjoyed some government support, including exports subsidies, but the national market remained quite closed. The EEC spurred the opening of the economy, with a strong increase in inward FDI that boosted the modernization of Spanish firms. The starting point for the internationalization of Basque firms can be traced, to some extent, to that moment, when a number of firms reacted to the new competitive environment and adjusted successfully to the new situation. At the beginning of the 1990s, firms 2, 7 and 8, which were in crisis, reconsidered their activities and their markets, and embarked on international expansion to overcome the critical situation.

The exponential expansion of firms has seen a considerable slowdown during recent years due to the financial and economic crisis, again raising the necessity to reinvent themselves and/or markets where they operate. Although the crisis affected all the firms studied here, internationalization was a form of insurance given the decline in local demand. Some firms are emerging in a reinforced position, particularly those with a presence in emerging economies. Those that depended more on the European market have suffered more from the effects of the crisis.

The internationalization of firms also depends as well on the dynamics of the sector. The automotive industry, for example, is simultaneously a global and a local sector: big manufacturers, both Original Equipment Manufacturers (OEMs) and first-tier providers ask
suppliers to locate nearby. This drove the rapid international expansion of Firm 3 from the start of the new century.

The main motive for the international expansion of our firms is the search for new markets (see Table 2) in order to gain size. In some cases the companies acquired an established firm in order to buy market knowledge, market share and a trademark. In the case of firm 7, for example, FDI as a means of boosting sales was for logistic reasons, because of the high cost of transportation of their product which made it difficult to compete in international markets when exporting from the home country.

Efficiency is less common as a motive for internationalization and, usually, is part of a broader strategy. Firm 4 established operations in Poland to gain both access to a market with high growth potential and lower labor costs. Firm 3 combined the market motive with efficiency by establishing production plants in lower cost countries, from where it supplied more developed countries e.g., from Eastern Europe to Germany, or from Mexico to the USA.

In mature industries such as home appliances, the degree of delocalization of production in Asian countries (especially China) is high. In order to obtain economies of scale, Firm 3 concentrated its productive plants in South America in Brazil.

Table 2: Drivers for Internationalization

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<th>Resources</th>
<th>Market</th>
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<td>Firm 8</td>
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Source: own elaboration. XX refers to main drivers. X refers to drivers that, even being important, were not the main driver for the internationalization decision of the firm.
In yet other instances, firms combine a search for new markets with a search for knowledge. This is the reason behind some acquisitions of firm 3, which bought a specialized firm in a key technology, the entrance of firm 6 in Mexico, and an acquisition in Austria by firm 8.

Finally, localization choices may also be determined by regulations. In those sectors that are considered sensitive or strategic such as telecommunications, defense, transportation, governments insist upon local content, that is, they demand that the totality or part of the production process be located in that country. A recent example of that is the establishment of operations of firm 3 in Russia.

In sum, although the main driver for the internationalization of firms seems to be market seeking, in the case of the firms studied here it is frequently combined with efficiency and knowledge seeking, bolstered in some cases by external forces such as client or government local requirements. (see Table 2, which summarizes the main drivers of internationalization).

**CONCLUDING REMARKS: REINVENTION IN A MULTIPOLAR WORLD**

In this new economic order that is emerging, both the main challenges and the main opportunities for firms in developed countries will come from the so-called emerging countries. On the one side, the Basque firms analyzed in this study (regardless of their sector of activity), are facing an increasingly fierce challenge from firms in emerging countries, with whom competing on price is difficult if not impossible. Moreover, the competitive profile of the latter companies is rapidly strengthening, as they not only compete on cost but on innovation. These emerging multinationals have the capacity to put into practice sophisticated competitive strategies in technologically advanced activities and capital-intensive projects. In the face of this, Basque firms must rely on innovation to differentiate themselves and establish a position in high value-added market niches.
On the other side, these countries also represent opportunities for Western countries. They have demographic weight, their economies are increasing in size, and an important proportion of their populations are attaining a purchasing power comparable to that of Europe and/or America.

In the face of this new reality, geographic diversification away from Europe and the USA is a challenge for Basque firms. Basque firms in general, and the firms analyzed in this paper, have a limited presence in emerging markets. China remains a major market to crack for most of them.

Since internationalization is a relatively recent phenomenon, one of the main challenges will be to consolidate their internationalization in the upcoming years, together with reducing operating risks in countries that are relatively unknown.

REFERENCES


## Appendix 1. MAIN CHARACTERISTICS OF THE FIRMS STUDIED

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</table>
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